Supreme Court, U.S.
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No. 07-

IN THE

Supreme Court of the United States

T-MOBILE USA, INC.,

Petitioner,

v.

BRUCE GATTON, JEWELDEAN HULL, CHRISTINA NGUYEN, CONOR VAUGHAN, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED; AND CHRISTINA NGUYEN, ADRIANNE GRANT, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California, First Appellate District

PETITION FOR A WRIT OF CERTIORARI

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February 7, 2008

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QUESTION PRESENTED

Whether this petition for certiorari should be held pending this Court's disposition of the petition for certiorari previously filed in *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008), given that both cases present the same important issue:

Whether, under the Federal Arbitration Act, a court may refuse to enforce the terms of an agreement to arbitrate based upon a state-law policy that individual arbitration is unconscionable in cases involving small claims by a consumer.

LIST OF PARTIES AND AFFILIATES

The parties are listed in the caption to this petition.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner T-Mobile USA, Inc. is a wholly-owned subsidiary of T-Mobile Global Holding GmbH, which is a wholly owned subsidiary of T-Mobile International AG, which, in turn, is a wholly owned subsidiary of Deutsche Telekom AG. Deutsche Telekom AG is a publicly traded company, of which approximately 14.83% and 16.87% is owned by the Federal Republic of Germany and the Kreditanstalt für Wiederaufbau (a bank controlled by the Government of the Federal Republic of Germany), respectively. No other publicly-held company owns 10% or more of T-Mobile USA, Inc.

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§ 4 5

PETITION FOR A WRIT OF CERTIORARI

Petitioner T-Mobile USA, Inc. ("T-Mobile") respectfully requests that this Court grant the petition for a writ of certiorari to review the decision and judgment of the California Court of Appeal, First Appellate District.

OPINIONS BELOW

The decision of the California Superior Court denying T-Mobile's motion to compel arbitration is unpublished and appears in the Appendix to this Petition ("Pet. App.") at 46a-60a. The decision of the California Court of Appeal in the consolidated appeal of *Gatton* v. *T-Mobile USA, Inc.* and *Nguyen* v. *T-Mobile USA, Inc.*, Nos. A112082 & A112084, 61 Cal. Rptr. 3d 344 (Cal. Ct. App. 2007) (portions unpublished) is reproduced at Pet. App. 1a to 45a. The October 10, 2007 Order of the California Supreme Court denying review of the Court of Appeal's judgment is reproduced at Pet. App. 61a.

JURISDICTION

The judgment of the California Court of Appeal was entered on June 22, 2007. On October 10, 2007, the California Supreme Court denied T-Mobile USA, Inc.'s petition for review. Pet. App. 61a. On December 20, 2007, Justice Kennedy granted T-Mobile's application for an extension of time, to and including February 7, 2008, within which to file a petition for a writ of certiorari. This Court has jurisdiction over this case pursuant to 28 U.S.C. § 1257(a); see *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-7 (1984); *Perry* v. *Thomas*, 482 U.S. 483, 489 n.7 (1987).

STATUTES INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides in pertinent part:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

STATEMENT OF THE CASE

This case presents the recurring question whether Section 2 of the Federal Arbitration Act ("FAA") permits state courts to refuse to enforce private agreements that expressly preclude class-based arbitration because state law deems individual arbitration of consumer claims to be substantively unconscionable. This is the same issue as that raised in the petition for certiorari in *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008). For the reasons fully outlined in the petition in *Laster*, the question presented there warrants the grant of certiorari. Accordingly, T-Mobile respectfully requests that this case be held pending disposition of the petition in *Laster* and resolved consistent with that petition.

Respondents purchased T-Mobile phones and entered into written agreements to resolve any disputes with T-Mobile through individual arbitration. Notwithstanding those agreements, Respondents filed two separate class actions on behalf of themselves and all similarly situated California consumers claiming that T-Mobile violated California law by (1) assessing early termination fees

when their service was terminated prior to the end of the agreed-upon contract period, and (2) allegedly inserting a locking device in wireless phones that prevents their use with other wireless service carriers.

The court below, applying prior California Supreme Court precedent in *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), held that the arbitration agreements were unenforceable because they provided exclusively for individual and not class-wide arbitration. Pet. App. 23a-24a. The California Court of Appeal's decision mirrors recent decisions by the Ninth Circuit, which have held that arbitration agreements are unenforceable if they only permit arbitration of disputes on an individual basis, *i.e.*, where class-wide arbitration is expressly forbidden. See, *e.g.*, *Shroyer* v. *New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007).

As set forth in T-Mobile's pending petition for certiorari in *Laster* (No. 07-976), these decisions are in conflict with the Third Circuit's ruling in *Gay* v. *CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007). There, the Third Circuit, relying on this Court's decision in *Perry* v. *Thomas*, 482 U.S. 483 (1987), ruled that the FAA precludes a court from refusing to enforce an agreement to arbitrate individually based upon a state-law determination that individual arbitration of small consumer claims is unconscionable. 2007 WL 4410362, at *20. The *Gay* court concluded that state unconscionability standards are preempted to the extent that they would render individual arbitration unenforceable. Denying enforcement on those grounds, the Third Circuit explained, would be tantamount to "'rely[ing] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would

be unconscionable.'" *Id.* (quoting *Perry*, 482 U.S. at 492 n.9).[1] Since the Third Circuit issued its decision in *Gay*, the Ninth Circuit expressly has declined "to follow the Third Circuit's holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008).

This case, like the ruling in *Laster*, implicates the same conflict over the enforceability of agreements to arbitrate consumer claims individually. In the ruling below, the California Court of Appeal applied *Discover Bank* to hold that the FAA does not require enforcement of these agreements. Pet. App. 24a-27a. In contrast, the Third Circuit in *Gay* ruled that the FAA does require enforcement of agreements that call for individual arbitration of consumer claims, and that it preempts state law to the contrary. Moreover, the Third, Fourth, Seventh, and Eleventh Circuits all have held – unlike the decision below – that individual arbitration allows for the effective resolution of claims in cases involving consumers. See Pet'n for Certiorari, *T-Mobile USA, Inc.* v. *Laster*, No. 07-976, at 11-25 (filed Jan. 23, 2008).

Resolution of this conflict is necessary because the proper application of the FAA to consumer arbitration agreements presents a recurring issue of

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[1] The *Gay* decision builds on decisions by other federal circuits holding that individual arbitration is appropriate for resolving federal and state claims by consumers in cases involving relatively small individual amounts. *See Johnson* v. *West Suburban Bank*, 225 F.3d 366, 373 (3d Cir. 2000); *accord Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 878 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006); *Livingston* v. *Associates Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 638-39 (4th Cir. 2002); *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814, 818 (11th Cir. 2001).

fundamental and national importance. The enforceability of agreements to arbitrate under the FAA is a matter that affects the rights of tens of millions of consumers and businesses. Indeed, a state-law rule that arbitration must provide a class-wide method of resolving disputes directly undercuts the benefit of arbitration as a streamlined, low-cost *alternative* to litigation. Decisions by courts that invalidate the terms of these arbitration agreements directly undermine the "primary purpose" of the FAA: to counteract judicial hostility to arbitration and to ensure that arbitration remains a viable alternative to litigation through enforcement of agreements to arbitrate in accordance with their terms. See *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989); 9 U.S.C. § 4; see also Pet'n for Certiorari, *T-Mobile USA, Inc.* v. *Laster*, No. 07-976, at 25-29 (filed Jan. 23, 2008).

T-Mobile thus requests that the petition in this case be held pending disposition of its petition for certiorari in *Laster*, No. 07-976 (filed Jan. 23, 2008).

STATUTORY BACKGROUND

In 1925, Congress enacted the FAA in response "to hostility of American courts to the enforcement of arbitration agreements." *Circuit City Stores* v. *Adams*, 532 U.S. 105, 111 (2001). Congress sought to promote arbitration as a meaningful alternative to litigation. "[B]y agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Indeed, "it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts [parties] to forgo access to judicial remedies." *Mitsubishi Motors Corp.* v. *Soler*

Chrysler-Plymouth, Inc., 473 U.S. 614, 633 (1985). For that reason, "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995).

The "primary purpose" of the FAA is to "ensur[e] that private agreements to arbitrate are enforced according to their terms." *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989). Arbitration agreements must be "rigorously enforce[d]" even if "the result is 'piecemeal' litigation." *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985). Indeed, Section 2 of the FAA "compels judicial enforcement of a wide range of written arbitration agreements," *Circuit City*, 532 U.S. at 111, "'notwithstanding any state substantive or procedural policies to the contrary.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

Under the FAA, "the underlying issue of arbitrability" is "a question of substantive federal law," *Southland Corp.* v. *Keating*, 465 U.S. 1, 12 (1984), that "must be addressed with a healthy regard for the federal policy favoring arbitration," *Moses H. Cone*, 460 U.S. at 24. In determining whether an agreement to arbitrate is enforceable, "the text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law." *Perry*, 482 U.S. at 492 n.9. As explained in *Perry*, "[a]n agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law* 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.'" *Id.* (quoting 9 U.S.C. § 2) (internal citation omitted; emphasis added by Court). "[S]tate law . . . is applicable *if* that law arose to govern issues concerning the

validity, revocability, and enforceability of contracts generally." *Id.* at 493 n.9.

"Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996); see *Perry*, 482 U.S. at 493 n.9. Likewise, courts may not (i) refuse enforcement based on state laws applicable only to certain types or categories of contracts, *Southland*, 465 U.S. at 16 n.11, or (ii) rely upon a fundamental aspect of arbitration as a basis for a ruling that arbitration is unconscionable, *Perry*, 482 U.S. at 493 n.9.

FACTUAL BACKGROUND

Petitioner T-Mobile markets and sells wireless telecommunications services, phones, and accessories throughout the United States. Wireless service and phones often are sold together in "bundled" transactions, in which consumers receive a free or significantly discounted phone, in exchange for agreeing to wireless service contracts for a term of one or two years. The customer service agreement specifies that customers will be charged an early termination fee if they cancel service after the return period, but before the end of their contract term, or if their service is canceled, for example, because of the customer's non-payment. Pet. App. 5a. The terms and conditions also specify that the phone will not be compatible with other wireless services. Appellant's Appendix in the California Court of Appeal ("AA") at 118.

The five named individuals in this consolidated proceeding are or were T-Mobile wireless subscribers. Pet. App. 2a. When they purchased service with T-Mobile, each signed a written customer service agreement ("Agreement") that contained an arbitration

clause. *Id.* at 3a. The Agreement provides that disputes will be resolved through individual arbitration rather than a class-wide proceeding. *Id.* at 4a-5a & n.3. Specifically, the terms and conditions provide that customers will arbitrate "any claim or dispute between [customer] and [T-Mobile] in any way related to or concerning the agreement, or [T-Mobile's] provision to [customer] of goods, services, or units." *Id.* at 4a n.3, 62a.[2]

Section 3 of the terms and conditions sets forth an arbitration agreement, which provides that it is governed by "the Federal Arbitration Act and federal arbitration law" and that "[n]either you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated or otherwise determined in one proceeding." Pet. App. 4a n.3, 62a-63a. The arbitration agreement is reproduced at Pet. App. 62a-64a.

Notwithstanding the Agreement, the five respondents filed two separate class actions in California state court that were later consolidated for the purposes of case management. Pet. App. 2a n.1. Respondents Gatton, Vaughan, Hull, and Nguyen advanced California causes of action related to the practice of assessing early termination fees for

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[2] Respondents also received the T-Mobile Welcome Guide, which sets forth in full the terms and conditions of service. The first paragraph advised, "'IF YOU DON'T AGREE WITH THESE [TERMS AND CONDITIONS], DO NOT USE THE SERVICE OR YOUR UNIT.'" Pet. App. 3a. The Agreement states that each consumer has 30 days to cancel his or her service with no further obligation and obtain a full refund. AA 186-87, 189-99. Respondents kept their phones, continued to use their service, and accepted T-Mobile's terms and conditions. Pet. App. 3a-5a.

customers whose service is terminated before the end of their contract period. See generally *Gatton*, Fourth Am. Compl. (AA 91-122). These respondents sought injunctive relief, compensatory damages, disgorgement of profits, "punitive damages," and "payment of reasonable attorneys' fees." *Id.* at 18-19 (AA 109-10).

Separately, Respondents Nguyen and Grant filed a class action alleging that T-Mobile installed a locking device in its phones that prevents subscribers from switching cell phone providers without purchasing a new phone. See *Nguyen*, Fourth Am. Compl. (AA 123-145). These respondents sought injunctive relief, restitution, and a judicial declaration that the class action waiver is unconscionable. *Id.* at 18-19 (AA 140-41).

The two lawsuits were consolidated before the same California Superior Court. Pet. App. 2a n.1. In July 2005, T-Mobile filed a motion to stay the proceedings in these two actions and to compel arbitration. *Id.* at 8a; AA 146-67. On September 7, 2005, the Superior Court denied T-Mobile's motion to compel arbitration, ruling instead that the arbitration agreement was unconscionable under *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), because it required individual arbitration. Pet. App. 58a. The Superior Court ruled that the Agreement was a contract of adhesion and thus "has some indications of procedural unconscionability." *Id.* at 50a. The court further ruled that the arbitration agreement was substantively unconscionable because it required individual arbitration and did not provide for class-wide arbitration. *Id.* at 50a-58a.

On June 22, 2007, the California Court of Appeal, First Appellate District, affirmed the ruling of the Superior Court. Pet. App. 2a. The Court of Appeal ruled that the arbitration agreement was

procedurally unconscionable because it was contained in a form contract. *Id.* at 20a. Next, the Court of Appeal ruled that the provision requiring individual arbitration in T-Mobile's agreement was substantively unconscionable under the California Supreme Court's decision in *Discover Bank*. *Id.* at 21a-24a. Finally, in the unpublished portion of its opinion, the Court of Appeal, again following *Discover Bank*, ruled that the FAA did not preempt its unconscionability analysis. *Id.* at 24a-27a (following *Discover Bank*, 113 P.3d at 1112).[3]

On October 10, 2007, the California Supreme Court denied T-Mobile's petition for review. Pet. App. 61a.

REASONS FOR GRANTING THE PETITION

This case implicates a conflict among the lower courts on the question whether the Federal Arbitration Act ("FAA") requires enforcement of agreements to arbitrate consumer disputes on an individual basis, or whether such agreements can be invalidated based on state-law policy in favor of class actions.

The issue presented in this case is the same as the one squarely presented in a prior petition filed by T-Mobile that is pending before this Court. *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008). Unlike this consolidated proceeding, the *Laster* case involves one set of claims arising in a single lawsuit

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[3] In dissent, Justice Jones would have enforced T-Mobile's arbitration agreement because he concluded that there was no procedural unconscionability. Pet. App. 42a. (Jones, P.J., dissenting). Justice Jones distinguished the consumer contract at issue in *Discover Bank*, which he concluded was more "susceptible to being oppressive" from T-Mobile's agreement, which "concerned a non-unique consumer good." *Id.* at 43a-44a.

in which plaintiffs assert allegations relating to the sales tax associated with the purchase of free or discounted wireless phones. See Pet'n for Writ of Certiorari, *Laster*, No. 07-976 at 6-11. For the reasons set forth in that Petition, T-Mobile submits that the *Laster* case presents an ideal vehicle to address and resolve the conflict presented in this case.

As such, T-Mobile requests that the Court grant review in *Laster* and hold the petition for certiorari in this case pending the disposition in *Laster*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be held pending the Court's disposition of *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008), and then disposed of accordingly.

Respectfully submitted,

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February 7, 2008

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APPENDIX

APPENDIX A

IN THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION FIVE

CERTIFIED FOR PARTIAL PUBLICATION *

[Filed June 22, 2007]

A112082, A112084
(Alameda County
Super. Ct. No. JCCP No. 4332
(RG03108118, RG04139536))

BRUCE GATTON *et al.*,
Plaintiffs and Respondents,

v.

T-MOBILE USA, INC.,
Defendant and Appellant.

CHRISTINA NGUYEN *et al.*,
Plaintiffs and Respondents,

v.

T-MOBILE USA, INC.,
Defendant and Appellant.

In this consolidated appeal, T-Mobile USA, Inc. appeals from an order denying its motion to compel

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* Pursuant to California Rules of Court, rules 8.1105 and 8.1110, this opinion is certified for publication with the exception of part II.

arbitration of actions challenging the early termination fee charged to cellular telephone service subscribers and challenging the practice of selling locked handsets that a subscriber cannot use when switching carriers. T-Mobile contends the court erred in concluding that the arbitration clause in its service agreement is unconscionable.

In the published portion of this opinion, we hold that the adhesive nature of the service agreement established a minimal degree of procedural unconscionability notwithstanding the availability of market alternatives and that the high degree of substantive unconscionability arising from the class action waiver rendered the arbitration provision unenforceable.

In the unpublished portion of this opinion, we reject T-Mobile's contention that the Federal Arbitration Act preempts any rule that class action waivers are unconscionable under California law.

We affirm the trial court order.

FACTUAL AND PROCEDURAL BACKGROUND

The Parties and the Service Agreements

T-Mobile USA, Inc. (T-Mobile) is a cellular telephone provider in California. Plaintiffs are or were subscribers to T-Mobile.[1]

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[1] The two cases from which these appeals arise are among the cases ordered consolidated in the Alameda County "Cellphone Termination Fee Cases," JCCP No. 4332. All cases concern unfair business practices actions against the seven major cell phone providers in California. For purposes of case management, the trial court divided the coordinated proceedings into three substantive topics: early termination, handset policies, and deposits.

All plaintiffs executed service agreements drafted by T-Mobile. Each agreement incorporated terms and conditions drafted by T-Mobile.[2] Directly above the signature line in the service agreement executed by plaintiffs is a short paragraph stating, "By signing below, you acknowledge you. . . . have received a copy of this Agreement. . . . You also acknowledge you have received and reviewed the T-Mobile Terms and Conditions, and agree to be bound by them. . . . All disputes are subject to mandatory arbitration in accordance with paragraph 3 of the Terms and Conditions."

The introductory paragraph to the terms and conditions incorporated into the agreement states: "Welcome to T-Mobile. BY ACTIVATING OR USING OUR SERVICE YOU AGREE TO BE BOUND BY THE AGREEMENT. Please carefully read these Terms and Conditions ("T&C's") as they describe your Service and affect your legal rights. IF YOU DON'T AGREE WITH THESE T&C'S, DO NOT USE THIS SERVICE OR YOUR UNIT." Similarly, the handset shipping box was sealed across the closing seam with a sticker that stated: "IMPORTANT[¶] Read the enclosed T-Mobile Terms & Conditions. By using T-Mobile service, you agree to be bound by the Terms & Conditions, including the mandatory arbitration and early termination fee provisions." The terms and conditions were also included in a "Welcome Guide" enclosed in the boxes containing the handsets.

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[2] The service agreements and terms and conditions applicable to the plaintiffs are not identical, but the differences are not material to the issues on appeal. Throughout this decision we will use the documents applicable to plaintiff Adrienne Grant as exemplars.

Section 3 of the terms and conditions incorporated into the agreement is entitled "Mandatory Arbitration; Dispute Resolution." It includes language waiving any right to seek classwide relief.[3] The terms and

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[3] Section 3 of the arbitration agreement provides:

> "YOU WILL FIRST NEGOTIATE WITH [T-MOBILE] IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND US IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES OR UNITS ("CLAIM"). YOU MUST SEND A WRITTEN DESPCRIPTION OF YOUR CLAIM TO OUR REGISTERED AGENT. [] IF YOU DO NOT REACH AGREEMENT WITH US WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION WITH THE AMERICAN ARBITRATION ASSOCIATION ("AAA") UNDER ITS PUBLISHED WIRELESS INDUSTRY ARBITRATION RULES, WHICH ARE A PART OF THE AGREEMENT BY THIS REFERENCE AND ARE AVAILABLE BY CALLING THE AAA AT [listed telephone number] OR VISITING ITS WEB SITE AT [listed]. . . . You will pay your share of the arbitrator's fees except (a) for claims less than $25, we will pay all arbitrator's fees and (b) for claims between $25 and $1000, you will pay $25 for the arbitrator's fee. You and we agree to pay our own other fees, costs and expenses including . . . .
>
> "Neither you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated or otherwise determined in one proceeding. While the prohibition on consolidated or classwide proceedings in this Sec. 3 will continue to apply: (a) you may take claims to small claims court, if they qualify for hearing by such court and (b) if you fail to timely pay amounts due, we may assign your account for collection and the collection agency may pursue such claims in court limited strictly to the collection of the past due debt and any interest or cost of collection permitted by law or the Agreement. YOU AND WE ACKNOWLEDGE AND

conditions incorporated into each of the plaintiff's agreements included a mandatory arbitration clause including a class action waiver.

Early Termination Fees Case (A112082)

The action of plaintiffs Gatton, Hull, Nguyen, and Vaughan, brought on behalf of themselves individually and on behalf of all similarly situated California residents, challenges the fee imposed by T-Mobile for termination of the service agreement before its expiration date.

The complaint includes the following allegations. The service agreement between T-Mobile and its subscribers is typically one or two years in duration. Under the terms of the agreement, subscribers who terminate the service before the expiration of the agreement are subject to an early termination penalty of approximately $200 per telephone. The early termination penalties are also imposed if T-Mobile terminates the agreement for, among other reasons, nonpayment by the subscriber. The amount of the fee does not vary according to how long the

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AGREE THAT THIS SEC. 3 WAIVES ANY RIGHT TO A JURY TRIAL OR PARTICIPATION AS A PLAINTIFF OR AS A CLASS MEMBER IN A CLASS ACTION. IF A COURT OR ARBITRATOR DETERMINES THAT YOUR WAIVER OF YOUR ABILITY TO PURSUE CLASS OR REPRESENTATIVE CLAIMS IS UNENFORCEABLE, THE ARBITRATION AGREEMENT WILL NOT APPLY AND OUR DISPUTE WILL BE RESOLVED BY A COURT OF APPROPRIATE JURISDICTION, OTHER THAN A SMALL CLAIMS COURT. SHOULD ANY OTHER PROVISION OF THIS ARBITRATION AGREEMENT BE DEEMED UNENFORCEABLE, THAT PROVISION SHALL BE REMOVED, AND THE AGREEMENT SHALL OTHERWISE REMAIN BINDING."

contract has been in effect at the time of termination; it is the same whether the contract has been in effect for several weeks or several months. The flat-fee early termination penalty constitutes an unlawful penalty under Civil Code section 1671, subdivision (d),[4] is unlawful under the unfair competition law (Bus. & Prof. Code, § 17200 et seq.), and is unconscionable under the Consumers Legal Remedies Act (CLRA) (Civ. Code, § 1750 et seq.).

Plaintiffs seek a permanent injunction prohibiting T-Mobile from collecting or enforcing the early termination penalty; a constructive trust on all monies collected as early termination penalties; and all other relief to which they are statutorily entitled, including restitution.

Handset Locking Case (A112084)

The action of plaintiffs Nguyen and Grant, brought on behalf of themselves individually and on behalf of all similarly situated California residents, challenges the practice of installing a locking device in T-Mobile handsets that prevents its subscribers from switching cell phone providers without purchasing a new handset.

The complaint includes the following allegations. The handsets T-Mobile sells its subscribers are manufactured by equipment vendors such as Nokia, Motorola, or Samsung. Each handset has a receptacle

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[4] Civil Code section 1671, subdivision (d) provides: "[A] provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the state of the case, it would be impracticable or extremely difficult to fix the actual damage."

into which a machine readable SIM (subscriber information module) card can be inserted. The card is approximately the size of a postage stamp and contains the subscriber and the provider identifying information. The SIM card can be inserted and removed by hand; no special tools or equipment are required. T-Mobile employs a SIM lock to prevent its handsets from operating with a SIM card programmed for any other network. The SIM lock can be unlocked by entering an eight digit code number; once unlocked, the handset will operate with any compatible SIM card for any network. T-Mobile requires equipment vendors to alter the handsets they sell to T-Mobile by locking them with SIM locks and setting the SIM unlock code based on a secret algorithm provided by T-Mobile. The agreement between T-Mobile and its subscribers falsely states that T-Mobile handsets are not compatible with and will not work with other wireless networks. That misrepresentation constitutes unfair competition and violates the CLRA. The secret locking makes it impossible or impracticable for subscribers to switch cell phone service providers without purchasing a new handset.

Plaintiffs seek an order directing T-Mobile to disclose the existence and effect of the handset locks and to offer to unlock the handsets free of charge; an injunction prohibiting T-Mobile from secretly programming and selling handsets with SIM locks and from representing that the handsets are not compatible with services provided by other wireless carriers; and for restitution and/or disgorgement of all amounts wrongfully charged to plaintiffs and members of the class.

Motion to Compel Arbitration

T-Mobile moved to compel arbitration of the two actions in accord with the service agreement. Plaintiffs opposed the motion on the grounds that (1) their claims for injunctive relief under the Unfair Competition Law and the CLRA were not arbitrable, and (2) their remaining claims were not arbitrable because the arbitration clause was unconscionable.

The trial court denied the motion to compel. It concluded that the claims for injunctive relief were primarily for the benefit of the public and, consequently, were not subject to arbitration. As to the other claims, it concluded that the arbitration provision was unconscionable and therefore unenforceable. The trial court held that although the indications of procedural unconscionability were "not particularly strong," under *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148 (*Discover Bank*), the arbitration clause was substantively unconscionable because its prohibition on class arbitrations or participation in a class action was against public policy.

DISCUSSION

Appellant T-Mobile contends the trial court erred in denying its motion to compel because the class action waiver did not render the arbitration provision unconscionable and because principles of federal preemption require enforcement of the provision.

I. *Unconscionability*

An agreement to arbitrate is valid except when grounds exist for revocation of a contract. (Code Civ. Proc., §§ 1281, 1281.2, subd. (b).) Unconscionability is one ground on which a court may refuse to enforce a contract. (Civ. Code, § 1670.5.) The petitioner, T-Mo-

bile here, bears the burden of proving the existence of a valid arbitration agreement and the opposing party, plaintiffs here, bears the burden of proving any fact necessary to its defense. (*Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 972.)

Whether a provision is unconscionable is a question of law. (Civ. Code, § 1670.5, subd. (a); *Flores v. Transamerica HomeFirst, Inc.* (2001) 93 Cal.App.4th 846, 851 (*Flores*).) On appeal, when the extrinsic evidence is undisputed, as it is here, we review the contract de novo to determine unconscionability. (*Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519, 1527 (*Stirlen*); *Flores,* at p. 851.)

The analytic framework employed by the California Supreme Court in determining whether a contract provision is unconscionable has its origins in *A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473 (*A & M Produce*). (See *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 114 (*Armendariz*).) Unconscionability has a procedural and a substantive element; the procedural element focuses on the existence of oppression or surprise and the substantive element focuses on overly harsh or one-sided results. (*Armendariz*, at p. 114, quoting *A & M Produce*, at pp. 486-487; see also *Discover Bank, supra*, 36 Cal.4th at p. 160.) To be unenforceable, a contract must be both procedurally and substantively unconscionable, but the elements need not be present in the same degree. (*Armendariz*, at p. 114.) The analysis employs a sliding scale: "the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." (*Ibid.*;

see also *Donovan v. RRL Corp.* (2001) 26 Cal.4th 261, 291.)

A. *The* Discover Bank *Decision*

Our analysis of the challenged arbitration provision is governed by the California Supreme Court decision *Discover Bank.* There, the court considered an unconscionability challenge to an arbitration provision prohibiting classwide arbitration in an agreement between a credit card company and its cardholders. (*Discover Bank, supra,* 36 Cal.4th at p. 152.) The provision was added to the agreement by a notice sent to cardholders. (*Id.* at p. 153.)

The court emphasized the "important role of class action remedies in California law." (*Discover Bank, supra,* 36 Cal.4th at p. 157.) "'Frequently numerous consumers are exposed to the same dubious practice by the same seller so that proof of the prevalence of the practice as to one consumer would provide proof for all. Individual actions by each of the defrauded consumers is often impracticable because the amount of individual recovery would be insufficient to justify bringing a separate action; thus an unscrupulous seller retains the benefits of its wrongful conduct. A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims. The benefit to the parties and the courts would, in many circumstances, be substantial.'" (*Id.* at p. 156, quoting *Vasquez v. Superior Court* (1971) 4 Cal.3d 800, 808.)

In analyzing the unconscionability issue, *Discover Bank* first concluded that "when a consumer is given an amendment to its cardholder agreement in the form of a 'bill stuffer' that he would be deemed to accept if he did not close his account, an element of procedural unconscionability is present." (*Discover Bank, supra*, 36 Cal.4th at p. 160.) Turning to the substantive element, the court stated "although adhesive contracts are generally enforced [citation], class action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy. [Citation.] As stated in Civil Code section 1668: 'All contracts *which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury* to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.' (Italics added.)" (*Discover Bank*, at p. 161.) The court acknowledged that class action and class arbitration waivers are not, in the abstract, exculpatory clauses, but because damages in consumer cases are often small and "because '"[a] company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit"' [citation], '"the class action is often the only effective way to halt and redress such exploitation."'" (*Ibid.*) Moreover, the court recognized that such class action and class arbitration waivers are "indisputably one-sided." (*Ibid.*) "'Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not sue their customers in class action lawsuits.'" (*Ibid.*)

In light of those considerations, *Discover Bank* held that when a waiver of classwide relief "is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ. Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced." (*Discover Bank, supra*, 36 Cal.4th at pp. 162-163.)

Against this legal backdrop, we consider the specific provision challenged here.

B. *Procedural Unconscionability*

The procedural element of the unconscionability analysis concerns the manner in which the contract was negotiated and the circumstances of the parties at that time. (*Kinney v. United HealthCare Services, Inc.* (1999) 70 Cal.App.4th 1322, 1329, citing *A & M Produce, supra*, 135 Cal.App.3d at p. 486.) The element focuses on oppression or surprise. (*Armendariz, supra*, 24 Cal.4th at p. 114.) "Oppression arises from an inequality of bargaining power that results in no real negotiation and an absence of meaningful choice." (*Flores, supra*, 93 Cal.App.4th at p. 853, citing *A & M Produce*, at p. 486.)[5] Surprise is defined as

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[5] Oppression in the manner of formation of the contract is distinguished from substantive oppressiveness of the challenged

"'the extent to which the supposedly agreed-upon terms of the bargain are hidden in the prolix printed form drafted by the party seeking to enforce the disputed terms.'" (*Stirlen, supra*, 51 Cal.App.4th at p. 1532, quoting *A & M Produce*, at p. 486.)

In their reply brief, plaintiffs did not dispute T-Mobile's assertion that the surprise aspect of procedural unconscionability is absent because the arbitration provision was fully disclosed to T-Mobile's customers. In response to our request for supplemental briefing, plaintiffs first urged that surprise is not necessary to find procedural unconscionability. Plaintiffs then asserted that we could find surprise because T-Mobile did not specifically bring to the attention of its customers that the arbitration provision included a class action waiver and because the print used in the agreement was small. We conclude that plaintiffs have not shown surprise. The arbitration provision was not disguised or hidden, and T-Mobile made affirmative efforts to bring the provision to the attention of its customers, including by referencing the provision on a sticker placed across the closing seam of the handset shipping box. (*Stirlen, supra*, 51 Cal.App.4th at p. 1532.) A finding of procedural unconscionability in this case cannot be based on the existence of surprise.

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provision. (See *Armendariz, supra*, 24 Cal.4th at p. 114 [referring to the "oppression" aspect of procedural unconscionability and also whether the challenged term is "substantively oppressive"]; *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 820 [considering whether a contract provision is unduly oppressive in substance].) Even if the manner of formation of a contract involves oppression and thereby satisfies the procedural unconscionability element, the challenged provision is unenforceable only if it is unduly unfair or oppressive in substance.

The California Supreme Court has consistently reiterated that "'[t]he procedural element of an unconscionable contract generally takes the form of a contract of adhesion.'" (*Discover Bank, supra*, 36 Cal.4th at p. 160; see also *Arrnendariz, supra*, 24 Cal.4th at p. 113 ["Unconscionability analysis begins with an inquiry into whether the contract is one of adhesion"]; *Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071.) Appellate courts considering unconscionability challenges in consumer cases have routinely found the procedural element satisfied where the agreement containing the challenged provision was a contract of adhesion. For example, in *Flores* we stated that "[a] finding of a contract of adhesion is essentially a finding of procedural unconscionability" (*Flores, supra*, 93 Cal.App.4th at p. 853), and in *Aral v. EarthLink, Inc.* (2005) 134 Cal.App.4th 544, 557, the court described an adhesive contract as "quintessential procedural unconscionability." (See also *Marin Storage & Trucking, Inc. v. Benco Contracting & Engineering, Inc.* (2001) 89 Cal.App.4th 1042, 1054 (*Marin Storage*); *Cohen v. DIRECTV, Inc.* (2006) 142 Cal.App.4th 1442, 1451.)

Whether the challenged provision is within a contract of adhesion pertains to the oppression aspect of procedural unconscionability. A contract of adhesion is ""'imposed and drafted by the party of superior bargaining strength'"" and ""'relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'"" (*Discover Bank, supra*, 36 Cal.4th at p. 160.) This definition closely parallels the description of the oppression aspect of procedural unconscionability, which "arises from an inequality of bargaining power that results in no real negotiation and an absence of meaningful choice." (*Flores, supra*, 93 Cal.App.4th at p. 853, citing *A & M Produce,*

supra, 135 Cal.App.3d at p. 486; see also *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 925, fn. 9 [noting that oppression arises from "unequal bargaining power"].) It is clear that the T-Mobile service agreement was a contract of adhesion: T-Mobile drafted the form agreement, its bargaining strength was far greater than that of individual customers, and customers were required to accept all terms and conditions of the agreement as presented or forgo T-Mobile's telephone service.

Nevertheless, T-Mobile argues that there was no oppression in the formation of the agreements because plaintiffs had the option of obtaining mobile phone service from one of two other providers whose agreements did not contain class action waivers. Preliminarily, we note that the evidence of the availability of market alternatives is exceedingly slim.[6] More fundamentally, we reject the contention that the existence of market choice altogether negates the oppression aspect of procedural unconscionability. "Procedural unconscionability focuses on the manner in which the disputed clause is presented to the party in the weaker bargaining position. When the weaker party is presented the clause and told to 'take it or

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[6] The same day plaintiffs filed the fourth amended complaint against T-Mobile in the coordinated Cellphone Termination Fee Cases, plaintiffs' counsel filed nearly identical third consolidated amended complaints against Nextel and Sprint. The Nextel and Sprint service agreements were attached to the respective complaints; these service agreements do not include arbitration provisions with class action waivers. T-Mobile's argument is based exclusively on these pleadings. We are not confronted with evidence that a consumer was actually aware of the existence of alternate providers and aware or should have been aware that the contracts used by those providers lacked the challenged contractual term.

leave it' without the opportunity for meaningful negotiation, oppression, and therefore procedural unconscionability, are present." (*Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 1100 (*Szetela*).) The existence of consumer choice decreases the extent of procedural unconscionability but does not negate the oppression and obligate courts to enforce the challenged provision regardless of the extent of substantive unfairness. The existence of consumer choice is relevant, but it is not determinative of the entire issue. (*Ibid.*)[7]

We considered market alternatives as a relevant factor in our decision in *Marin Storage, supra*, 89 Cal.App.4th 1042. There, a general contractor challenged the enforceability of an indemnification provision in a form subcontract created by a crane rental company. (*Id.* at pp. 1046-1048.) The procedural element was satisfied because the agreement at issue was "a contract of adhesion and, hence, procedurally unconscionable." (*Id.* at p. 1054.) But the degree of procedural unconscionability was limited because the contractor was sophisticated and had choice in selecting crane providers; in fact the plaintiff had done business with ten other firms. (*Id.* at p. 1056.) We also considered substantive unconscionability and concluded that, viewed in its commercial context, the indemnification provision was not overly one-sided or

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[7] Notably, we believe the issue before us is properly framed as whether the existence of market choice negates the existence of oppression, not whether choice renders a contract nonadhesive. (*Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1319-1320 & fn. 6; see also *Marin Storage, supra*, 89 Cal.App.4th at pp. 1054-1056; *Wayne v. Staples, Inc.* (2006) 135 Cal.App.4th 466, 483; but see *Szetela, supra*, 97 Cal.App.4th at p. 1100.)

unreasonable. (*Id.* at pp. 1055-1056.) Balancing the procedural and substantive elements, we concluded that "[i]n light of the low level of procedural unfairness . . . a greater degree of substantive unfairness than has been shown here was required before the contract could be found substantively unconscionable." (*Id.* at p. 1056; see also *Woodside Homes of Cal., Inc. v. Superior Court* (2003) 107 Cal.App.4th 723, 730 [because plaintiff home buyers were not unsophisticated or lacking in choice, they established only a "low level" of procedural unconscionability and were obligated to establish "a *high* level of substantive unconscionability"].)

The *Marin Storage* approach is consistent with the instruction in *Armendariz, supra*, 24 Cal.4th at p. 114, that the elements of procedural and substantive unconscionability "need not be present in the same degree." The court explained: "'Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves.' [Citations.] In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." *(Ibid.)*

In the three appellate decisions relied on by T-Mobile to support its approach to procedural unconscionability, the results would be the same under the *Marin Storage* reasoning. In two, the courts, like *Marin Storage*, actually rejected the unconscionability claims only after finding no clear substantive unfairness. (*Morris v. Redwood Empire Bancorp, supra*, 128 Cal.App.4th at p. 1322 ["In sum, we are

able to discern little or no procedural unconscionability from the allegations of the second amended complaint. . . . [¶] We now turn our analysis to substantive unconscionability"]; *Wayne v. Staples, Inc., supra*, 135 Cal.App.4th at p. 483.) Critically, any substantive unconscionability was relatively minor: *Morris* involved only a $150 fee charged upon termination of a credit card merchant account; *Staples* involved allegedly excessive charges for "declared value coverage" but the charges were "comparable to the amount charged by other retailers of shipping services." (*Morris*, at pp. 1323-1324; *Staples*, at p. 483.) In the third, *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal.App.3d 758, 772 (*Dean Witter*), while the court did not reach the issue of substantive unconscionability, the challenged provision was a relatively insignificant $50 fee for terminating an individual retirement account.

The cases are distinguishable because in each there was not a high degree of substantive unconscionability that could justify a court "'disregard[ing] the regularity of the procedural process of the contract formation.'" (*Armendariz, supra*, 24 Cal.4th at p. 114.) In other words, because any substantive unconscionability was low, the sliding scale analysis did not provide a basis to refuse to enforce the provisions in light of the minimal procedural unconscionability.

The rule T-Mobile asks us to adopt disregards the sliding scale balancing required by *Armendariz*; in the absence of evidence of surprise, the proposed rule would allow any evidence of consumer choice to trump all other considerations, mandating courts to enforce the challenged provisions without considering the degree of substantive unfairness and the poten-

tial harm to important public policies. Although contracts of adhesion are well accepted in the law and routinely enforced, the inherent inequality of bargaining power supports an approach to unconscionability that preserves the role of the courts in reviewing the substantive fairness of challenged provisions. (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal.3d at pp. 817-818; *Marin Storage, supra*, 89 Cal.App.4th at p. 1052.) Otherwise, the imbalance of power creates an opportunity for overreaching in drafting form agreements. (See *Graham v. Scissor-Tail*, at pp. 817-818.) The possibility of overreaching is even greater in ordinary consumer transactions involving relatively inexpensive goods or services because consumers have little incentive to carefully scrutinize the contract terms or to research whether there are adequate alternatives with different terms, and companies have every business incentive to craft the terms carefully and to their advantage. The unconscionability doctrine ensures that companies are not permitted to exploit this dynamic by imposing overly one-sided and onerous terms. (*Ibid.*) In sum, there are provisions so unfair or contrary to public policy that the law will not allow them to be imposed in a contract of adhesion, even if theoretically the consumer had an opportunity to discover and use an alternate provider for the good or service involved.

We reject the rule proposed by T-Mobile. Instead we hold that absent unusual circumstances,[8] use of a

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[8] Such unusual circumstances were arguably present in *Dean Witter*, where the court held only that the challenged provision was not procedurally unconscionable "as to the sophisticated investor-attorney specializing in class action litigation involving financial institutions, who sought and obtained appointment here as the class representative." (*Dean Witter, supra*, 211 Cal.App.3d at p. 772.) Where the plaintiff is highly sophisticated

contract of adhesion establishes a minimal degree of procedural unconscionability notwithstanding the availability of market alternatives. If the challenged provision does not have a high degree of substantive unconscionability, it should be enforced. But, under *Armendariz, supra*, 24 Cal.4th at p. 114, we conclude that courts are not obligated to enforce highly unfair provisions that undermine important public policies simply because there is some degree of consumer choice in the market.

The Ninth Circuit, sitting en banc in *Nagrampa v. MailCoups, Inc.* (9th Cir. 2006) 469 F.3d 1257, reached the same conclusion. There, a franchisee contended that an arbitration provision in a contract of adhesion was unconscionable. (*Id.* at p. 1281.) The court rejected the franchisor's argument that the availability of other franchising opportunities could alone defeat the plaintiff's claim of procedural unconscionability. (*Id.* at p. 1283.) Because the franchisor had overwhelming bargaining power, drafted the contract, and presented it on a take-it-or-leave-it basis, there was "minimal" evidence of procedural unconscionability. (*Id.* at p. 1284.) The court reasoned that the minimal showing was "sufficient to require us, under California law, to reach the second prong of the unconscionability analysis. We therefore next examine the extent of substantive unconscionability to determine, whether based on the California courts' sliding scale approach, the arbitration provision is unconscionable." (*Ibid.*)

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and the challenged provision does not undermine important public policies, a court might be justified in denying an unconscionability claim for lack of procedural unconscionability even where the provision is within a contract of adhesion.

We conclude that plaintiffs showed a minimal degree of procedural unconscionability arising from the adhesive nature of the agreement. But this is "'the beginning and not the end of the analysis insofar as enforceability of its terms is concerned.'" (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal.3d at p. 819.)[9] Under the sliding scale approach, plaintiffs were obligated to make a strong showing of substantive unconscionability to render the arbitration provision unenforceable.

C. *Substantive Unconscionability*

The substantive element of the unconscionability analysis focuses on overly harsh or one-sided results. (*Armendariz, supra*, 24 Cal.4th at p. 114; *Flores, supra*, 93 Cal.App.4th at p. 853.) In light of *Discover Bank*, we conclude that the challenged provision has a high degree of substantive unconscionability.

In considering whether class action waivers may be unconscionable, *Discover Bank* emphasized that class actions are often the only effective way to halt corporate wrongdoing and that class action waivers

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[9] The Supreme Court continued, "Thus, a contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal.3d at pp. 819-820.) One of the bases to refuse enforcement described by the Supreme Court is an "unconscionability" analysis focusing entirely on the degree of substantive unfairness of the challenged provision, which is parallel to the "substantive unconscionability" analysis in *A & M Produce, supra*, 135 Cal.App.3d 473. (*Graham v. Scissor-Tail*, at pp. 821-828; *California Grocers Assn. v. Bank of America* (1994) 22 Cal.App.4th 205, 213-214.) The adhesive nature of the contract alone justifies scrutiny of the substantive fairness of the contractual terms. (*Graham v. Scissor-Tail*, at pp. 824-825.)

are "indisputably one-sided" because companies typically do not sue their customers in class action lawsuits. (*Discover Bank, supra,* 36 Cal.4th at p. 161.) The court did not conclude that all class action waivers are necessarily unconscionable, but the court did hold that "when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money," then the waiver is exculpatory in effect and unconscionable under California law. (*Discover Bank, supra*, 36 Cal.4th at pp. 162-163; see also *Cohen v. DIRECTV, Inc., supra*, 142 Cal.App.4th at pp. 1451-1454; *Klussman v. Cross Country Bank* (2005) 134 Cal.App.4th 1283, 1297-1298; *Aral v. EarthLink, Inc., supra*, 134 Cal.App.4th at pp. 555-557; *Szetela, supra,* 97 Cal.App.4th at pp. 1100-1102 [cited with approval in *Discover Bank*].)

T-Mobile contends that this case is distinguishable from *Discover Bank* on two grounds. First, the amount in controversy exceeds the $29 late payment fee involved in *Discover Bank.* The largest monetary damage claim is the $200 early termination fee. We agree with *Cohen v. DIRECTV, Inc., supra*, 142 Cal.App.4th at p. 1452, which rejected the same argument T-Mobile makes. The court reasoned: "While $1,000 is not an insignificant sum, many consumers of services such as those offered by DIRECTV may not view that amount as sufficient '"'"to warrant individual litigation,"'"' and certainly it is not sufficient to obtain legal assistance in prosecuting the claim.' [*Discover Bank, supra*, 36 Cal.4th at p. 157.] In short, the class action device remains, in our view,

the only practicable way for consumers of services such as DIRECTV's to deter and redress wrongdoing of the type Cohen alleges. Damages that may or may not exceed $1,000 do not take DIRECTV's class action waiver outside 'a setting in which disputes between the contracting parties predictably involve small amounts of damages. . . .'" (*Cohen*, at p. 1452.) The same is true in this case.

Second, T-Mobile contends that the class action waiver would not exculpate the company from any wrongdoing because, unlike in *Discover Bank*, plaintiffs assert inarbitrable claims for public injunctive relief. However, under *Discover Bank's* reasoning, the class action waiver would at the very least effectively exculpate T-Mobile from the alleged fraud perpetrated on the class members, which is enough to bring this case within the scope of the *Discover Bank* holding. Moreover, *Discover Bank* rejected the argument that private lawsuits seeking injunctive relief and attorney fees awards are an adequate substitute for class actions. The court specifically stated that it was not persuaded that the problems posed by class action waivers are ameliorated by the availability of attorney fees awards in private litigation or the availability of public actions (brought by the Attorney General or other designated law enforcement officials) for injunctive relief and civil penalties. (*Discover Bank, supra*, 36 Cal.4th at p. 162; see also *id.* at p. 180 (dis. opn. of Baxter, J.).)

In the consumer context, class actions and arbitrations are "often inextricably linked to the vindication of substantive rights." (*Discover Bank, supra*, 36 Cal.4th at p. 161.) There is nothing extraordinary about the circumstances of this case that distinguishes it from the typical consumer class actions

described in *Discover Bank*. Because it is directly within the scope of the holding in that case, we conclude that the class action waiver has a high degree of substantive unconscionability. Applying the sliding scale test for unconscionability, even though the evidence of procedural unconscionability is limited, the evidence of substantive unconscionability is strong enough to tip the scale and render the arbitration provision unconscionable. The trial court properly denied the motion to compel arbitration.[10]

II. *Federal Preemption*

T-Mobile further contends that the Federal Arbitration Act (FAA) preempts any rule that class action waivers are unconscionable under California law. The Supreme Court rejected this contention in *Discover Bank*.

Under federal law, an arbitration agreement containing a clause prohibiting class actions must be treated in the same manner as any other contract containing such a clause. As the United State Supreme Court has explained, "In instances [where defenses such as unconscionability are asserted], the text of § 2 [of the FAA] provides the touchstone for

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[10] Arguably, the CLRA's non-waiver provision, Civil Code section 1751, provides an independent basis for affirming denial of the motion to compel arbitration. (See *America Online, Inc. v. Superior Court* (2001) 90 Cal.App.4th 1; *Discover Bank, supra*, 36 Cal.4th at pp. 158-159.) T-Mobile contends that the Federal Arbitration Act preempts any application of Civil Code section 1751 to deny enforcement of the arbitration provision, citing *Ting v. AT&T* (9th Cir. 2003) 319 F.3d 1126, 1147-1148. Because we conclude that the arbitration provision is unconscionable, we need not decide the Civil Code section 1751 issue nor the other challenges to the service agreement raised by plaintiffs.

choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, [citation], 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.' [Citation.] Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. [Citations.] A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot." (*Perry v. Thomas* (1987) 482 U.S. 483, 492-493, fn. 9.)

The California Supreme Court applied these federal preemption principles in *Discover Bank*. The Court of Appeal held that the trial court's invalidation of the arbitration provision was preempted by the FAA. The Supreme Court declared itself "puzzl[ed]" by the Court of Appeal's conclusion that "'[w]hile a state may prohibit the contractual waiver of statutory consumer remedies, including the right to seek relief in a class action, such protections fall by the wayside when the waiver is contained in a validly formed arbitration agreement governed by the FAA.'" (*Discover Bank, supra*, 36 Cal.4th at p. 165.) The

Court of Appeal's conclusion "ignore[d] the critical distinction made by the *Perry* court between a 'state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue,' which is preempted by section 2 of the FAA, and a state law that 'govern[s] issues concerning the validity, revocability, and enforceability of contracts generally,' which is not." (*Ibid.*, quoting *Perry v. Thomas, supra*, 482 U.S. at p. 493, fn. 9.) As *Discover Bank* explained, "the principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally. . . . [i]t applies equally to class action litigation waivers in contracts without arbitration agreements as it does to class arbitration waivers in contracts with such agreements. [Citation.] In that important respect it differs from the provision under consideration in *Perry*, which singled out certain arbitration agreements as unenforceable." (*Discover Bank*, at pp. 165-166.) Put simply, "Nothing in . . . any . . . [United States] Supreme Court case . . . suggests that state courts are obliged to enforce contractual terms even if those terms are found to be unconscionable or contrary to public policy under general contract law principles." (*Id.* at p. 166; see also *Aral v. EarthLink, Inc., supra*, 134 Cal.App.4th at pp. 553-555 [following *Discover Bank*]; *Klussman v. Cross Country Bank, supra*, 134 Cal.App.4th at pp. 1290-1291.)

Discover Bank also rejected T-Mobile's argument that a prohibition on class action waivers is preempted because class proceedings are fundamentally incompatible with arbitration. (*Discover Bank, supra*, 36 Cal.4th at pp. 171-173.)

We are bound to follow the preemption analysis in *Discover Bank* that is directly applicable. *(Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455.) T-Mobile's federal preemption argument fails.[11]

DISPOSITION

The order denying the motion to compel arbitration is affirmed. Costs are awarded to plaintiffs.

GEMELLO, J.

I concur.

SIMONS, J.

[11] T-Mobile also asserts that California Supreme Court decisions holding claims for public injunctive relief inarbitrable, *Broughton v. Cigna Healthplans* (1999) 21 Cal.4th 1066 and *Cruz v. PacifiCare Health Systems, Inc.* (2003) 30 Cal.4th 303, were incorrectly decided on the preemption issue and that that Proposition 64, approved by the voters at the November 2, 2004 General Election, which amended California's unfair competition law (Bus & Prof. Code, § 17200 et seq.), has undermined the decisions. We are not at liberty to overrule the decisions of the Supreme Court (*Auto Equity Sales, Inc. v. Superior Court, supra*, 57 Cal.2d at p. 455), and T-Mobile's argument provides insufficient basis for us to declare *Broughton* and *Cruz* distinguishable.

JONES, P.J., Concurring and Dissenting

Under compulsion of *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148 (*Discover Bank*), I concur in my colleagues' conclusion that the arbitration clauses before us are substantively unconscionable because of the prohibition in the mandatory arbitration provision against the pursuit of any remedy by a plaintiff as a representative of other potential claimants or class of claimants. But I cannot agree that the contracts are also procedurally unconscionable. In my view, plaintiffs do not show, on the record before us, either surprise or oppression to support their procedural unconscionability claim. In the absence of both procedural and substantive elements of unconscionability, this court should decline to exercise its discretion to refuse to enforce the disputed clause. (*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 114 (*Armendariz*).) The trial court erred when it denied the motion to compel arbitration, and its order so holding should be reversed.

BACKGROUND

It is undisputed that the challenged terms of the cellular telephone service agreement were drafted by cellular telephone provider T-Mobile and executed by each plaintiff when he/she signed up for T-Mobile cellular telephone service. The contracts were presented on a "take-it-or-leave-it" basis, were not subject to negotiation, and were therefore adhesive contracts. As recounted by the majority, a short paragraph directly above the signature line contained a statement that the customer's signature constituted the customer's acknowledgement of receipt, review of, and agreement to be bound by "the T-Mobile Terms and Conditions," and that "All disputes are subject to

mandatory arbitration in accordance with paragraph 3 of the Terms and Conditions." A second notice appeared in the introductory paragraph, cautioning subscribers in capitalized letters that "BY ACTIVATION OR USING OUR SERVICE YOU AGREE TO BE BOUND BY THE AGREEMENT . . . IF YOU DON'T AGREE WITH THESE T&C'S, DON'T USE THIS SERVICE OR YOUR UNIT."

Customers were given a third notice on the closing seam of the shipping box containing the newly purchased handset. The box was sealed with a sticker that stated: "*IMPORTANT* Read the enclosed T-Mobile Terms & Conditions. By using T-Mobile service, you agree to be bound by the Terms & Conditions, including the mandatory arbitration and early termination fee provisions."

Once the shipping box was opened, the subscriber found a "Welcome Guide." Page three of the "Welcome Guide" was a table of contents, which listed "Terms and Conditions" as one of the sections of the guide. At the bottom of the table of contents was the statement: "Important Note: By using T-Mobile service, you acknowledge that you have read and agree to the terms and conditions of the Service Agreement." The "Terms and Conditions" included in the welcome guide was identical to the terms and conditions given to the customers before they signed their service agreements, including the same introductory paragraph admonishing the customer to read the terms and conditions carefully and not to use the service if they did not agree with all terms and conditions.

Section 5 of the terms and conditions, entitled "Cancellation and Return Policy," describes a "Return Period." It states, "[t]here is a Return Period during

which you can cancel a newly activated line of Service without paying a cancellation fee. The Return Period is 14 calendar days from the date of Service activation or 30 days from the Phone's purchase date if you have not activated service. . . . You may be required to pay a restocking fee. . . ."

The actions brought by plaintiffs Gatton, Hull, Nguyen and Vaughan, on behalf of themselves individually and on behalf of all similarly situated California residents, challenged the term in T-Mobile's service agreement which imposed a fee for termination of the service agreement before its expiration date. The action of plaintiffs Nguyen and Grant, brought on behalf of themselves individually and on behalf of all similarly situated California residents, concerns a locking device installed in T-Mobile handsets that prevents its subscribers from switching cell phone providers without purchasing a new handset.

DISCUSSION

It is well settled that an agreement to arbitrate is valid, irrevocable, and enforceable except when grounds exist for the revocation of any contract (Code Civ. Proc., §§ 1281, 1281.2, subd. (b)), and it is equally settled that a court can refuse to enforce an unconscionable provision in a contract. (Civ. Code, § 1670.5; *Armendariz, supra*, 24 Cal.4th at pp. 83, 114.)

1. *Unconscionability*

In *Discover Bank* our Supreme Court "'briefly recapitulate[d] the principles of unconscionability'" in the context of a challenge to a mandatory arbitration clause forbidding classwide arbitration that was added to the plaintiff's bank credit card agreement 13 years after the plaintiff obtained the card. The bank

informed the plaintiff that continued use of the card would be deemed acceptance of the new terms unless the cardholder notified the bank that he did not want to accept the new terms and ceased using his account. (*Discover Bank, supra*, 36 Cal.4th at pp. 154, 160.) "[T]he doctrine has '"both a "procedural" and a "substantive" element,' the former focusing on '"oppression"' or '"surprise"' due to unequal bargaining power, the latter on '"overly harsh"' "or" '"one-sided"' results." [Citation.] The procedural element of an unconscionable contract generally takes the form of a contract of adhesion, '"which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contact or reject it.' [¶] Substantively unconscionable terms may take various forms, but may generally be described as unfairly one-sided.' (*Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071 (*Little*)." (*Discover Bank, supra*, 36 Cal.4th at p. 160.)[1]

Discover Bank continued: "We agree that at least some class action waivers in consumer contracts are unconscionable under California law. First, when a consumer is given an amendment to its cardholder agreement in the form of a 'bill stuffer' that he would be deemed to accept if he did not close his account, an element of procedural unconscionability is present.

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[1] The definition of "contract of adhesion" that appears in the quote from *Little*—"imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it"—is taken from *Neal v. State Farm Ins. Co.* (1961) 188 Cal.App.2d 690, 694 (*Neal*). *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817 (*Scissor-Tail*), characterized it as the "serviceable general definition [that has] well stood the test of time and will bear little improvement."

[quoting *Szetela v. Discover Bank* (2002) 97 Cal. App.4th 1094, 1100 (*Szetela*).] Moreover, although adhesive contracts are generally enforced [quoting *Scissor-Tail*], class action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy." (*Discover Bank, supra*, 36 Cal.4th at pp. 160-161.)

For a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability, *both* procedural and substantive unconscionability must be present, although not necessarily in the same degree. (*Armendariz, supra*, 24 Cal.4th at p. 114; see also *A&M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, 487, 493 (*A&M Produce*).) T-Mobile contends the service agreement at issue here is not procedurally unconscionable because there was no showing of surprise or oppression.[2] I agree.

2. *Procedural Unconscionability*

A. Surprise

T-Mobile argues that plaintiffs cannot claim surprise regarding the service agreement's arbitration

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[2] In a single paragraph the trial court concluded the service agreement has "some indications" of procedural unconscionability, but "these [unidentified] indications are not particularly strong." But the court's actual references reflect the absence of procedural unconscionability. The court noted that adhesive contracts are generally enforced, that the arbitration provision is in paragraph 3 of the agreement and in capital letters (implying it was not hidden from the purchaser), that the contract comes with the phone and is accepted by use of the phone, and that use of a form contract and acceptance by using the product are not per se unconscionable. It denied the motion to compel after concluding that it was substantively unconscionable under the *Discover Bank* analysis.

provision because the provision was fully disclosed to potential purchasers. As the majority notes, plaintiffs conceded in their reply brief the absence of the surprise component of procedural unconscionability. Plaintiffs' efforts to resurrect this argument in supplemental briefing must fail. The record contains ample evidence of T-Mobile's disclosures and admonitions given to subscribers before and after the purchase. The quantity and prominence of the disclosures and the grace period of 14 days from service activation or 30 days from purchase if no activation, should a customer decide he or she did not want to accept the terms of the service agreement, demonstrate the absence of surprise to support procedural unconscionability. I turn then to the issue of oppression.

B. Oppression

T-Mobile argues the oppression element of procedural unconscionability is lacking because plaintiffs could obtain mobile phone service from other providers whose agreements did not contain a mandatory arbitration provision and because there are no other indicia of oppression. Plaintiffs counter that the service agreement "provides a maximum degree of procedural unconscionability" because it is a standard form, preprinted, nonnegotiable contract of adhesion presented to them on a "take it or leave it" basis.

The oppression component of procedural unconscionability has long been described as arising from an inequality of bargaining power of the parties to the contract which results in no real negotiation and an absence of meaningful choice on the part of the weaker party. (*A&M Produce, supra*, 135 Cal.App.3d at p. 486; see also *Wayne v. Staples, Inc.* (2006)

135 Cal.App.4th 466, 480; *Crippen v. Central Valley RV Outlet* (2004) 124 Cal.App.4th 1159, 1164; *Kinney v. United HealthCare Services, Inc.* (1999) 70 Cal.App.4th 1322, 1329.)

The majority ascribes to the California Supreme Court a consistent position that "'[t]he procedural element of an unconscionable contract generally takes the form of a contract of adhesion.'" [Maj. at p. 10.] (*Discover Bank, supra*, 36 Cal.4th at p. 160, quoting *Little, supra*, 29 Cal.4th at p. 1071; see also *Armendariz, supra*, 24 Cal.4th at p. 113.) While our Supreme Court has repeated the quoted statement, I cannot agree that our high court views procedural unconscionability as established based only on the presence of "unequal bargaining power" (see *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 925, fn. 9) or "an inequality of bargaining power that results in no real negotiation and an absence of meaningful choice" (*Flores v. Transamerica Home First, Inc.* (2001) 93 Cal.App.4th 846, 853 (*Flores*), quoting *A&M Produce, supra*, 135 Cal.App.3d at p. 486). A review of the origin of these definitional statements leads me to conclude that more than the existence of an adhesive contract is required.

Critical to an unconscionability analysis is *Scissor-Tail, supra*, 28 Cal.3d 807, in which the plaintiff contended he should not be compelled to arbitrate a dispute because the underlying agreement, at least to the extent it required arbitration of disputes between the parties, was "an unenforceable contract of adhesion." (*Id.* at p. 817.) *Scissor-Tail* concluded the agreement was adhesive, i.e., a "'standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to

the contract or reject it.'" (*Ibid.*, quoting *Neal, supra*, 188 Cal.App.2d at p. 694.) But *Scissor-Tail* continued: "To describe a contract as adhesive in character is not to indicate its legal effect. It is, rather, 'the beginning and not the end of the analysis insofar as enforceability of its terms is concerned. [Citation.] Thus, a contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (*Scissor-Tail, supra*, at p. 819, fns. omitted.) No subsequent case has disapproved this language. Indeed, although *Discover Bank* recited the *A&M Produce* analytic framework, *Discover Bank* also observed that contracts of adhesion are generally enforced, specifically quoting *Scissor-Tail*. (*Discover Bank, supra*, 36 Cal.4th at pp. 160, 161.)

Reading *Scissor-Tail* together with *A&M Produce*, and particularly the phrase in the latter decision—"an absence of meaningful choice on the part of the weaker party"—, I conclude there is no taint of unconscionability from the bare fact that a contract is adhesive. Other factors must be present to preclude enforceability on grounds of unconscionability.

I recognize that a number of cases have implied, if not stated outright, that a contract of adhesion is inherently procedurally unconscionable. (See, e.g., *Flores, supra*, 93 Cal.App.4th at pp. 853-584; *Marin Storage & Trucking, Inc. v. Benco Contracting & Engineering, Inc.* (2001) 89 Cal.App.4th 1042, 1053 (*Marin Storage*); *Kinney v United Health Care, supra*, 70 Cal.App.4th at p. 1329 (*Kinney*); *Martinez v Master Protection Corp.* (2004) 118 Cal.App.4th 107, 114 (*Martinez*).) "Analysis of unconscionability begins with an inquiry into whether the contract was a

contract of adhesion—i.e., a standardized contract, imposed upon the subscribing party without an opportunity to negotiate the terms. [Citations.] A finding of a contract of adhesion is essentially a finding of procedural unconscionability. [Citations.]" (*Flores, supra*, 93 Cal.App.4th at p. 853.) However, a review of the nature and/or timing of the offer of the disputed contract provisions to plaintiffs in these cases generally shows the presence of facts supporting procedural unconscionability beyond the bare existence of a contract of adhesion.

Flores, for example, concerned a "Loan Agreement and Note" and deed of trust for a reverse mortgage with a mandatory arbitration clause, which did not appear until page 11, section 20 of the 14-page agreement. (*Flores, supra*, 93 Cal.App.4th at p. 849.) Moreover, the "IMPORTANT INFORMATION FOR ALL BORROWERS" given to the 80- and 76-year-old plaintiffs indicated they were required to sign the standardized loan documents in order to establish the reverse mortgage; the plaintiffs were never told the loan documents were negotiable; and the mortgage company representative told them that the company was the only one in California that offered reverse mortgages, thereby indicating they had no real choice of alternate lenders. (*Id.* at pp. 851, 853.) Not only was the arbitration agreement presented on a "take it or leave it basis," but the borrowers were affirmatively told they had no real alternative.

Marin Storage involved an indemnification clause that appeared on the reverse side of a document that described itself as a "Work Authorization and Contract," but which was more obviously an invoice for work performed than a contract. (*Marin Storage, supra*, 89 Cal.App.4th at p. 1047.) The reverse side

was difficult to read and was presented for signature at the job site with no reasonable opportunity to read or consider the terms, and, according to the evidence, the document was treated by the plaintiff corporation as an invoice, not a contract purporting to modify the critical allocation of risks and liability for damages. (*Id.*, at pp. 1053, 1054.) While we found "no error in the trial court's conclusion that the [contract] was a contract of adhesion and, hence, procedurally unconscionable," the evidence concerning the appearance and presentation of the contract readily comported with the "unfair surprise" element of procedural unconscionability, i.e., supposedly agreed-upon terms that are hidden in a prolix printed form and never brought to the attention of the weaker party. (See *A&M Produce, supra*, 135 Cal.App.3d at pp. 486, 488, 490.)

Kinney, supra, 70 Cal.4th 1322 involved a mandatory arbitration policy contained in an employee handbook issued by an employer health care services corporation. The employer required an employee with six years service to sign an acknowledgment of receipt of the handbook when she returned to work after a hospitalization. (*Id.* at pp. 1324-1326.) The employee was pressured to sign the form acknowledging receipt of the handbook the same day she received it, precluding her from reviewing the handbook or its arbitration clause. Significantly, the language used in the policy to describe its scope was so extensive as to make it difficult for a layperson to read and understand its parameters. ". . . [A]fter a statement of intent extolling the virtues of . . . the arbitration process, the policy provides, in a fairly lengthy paragraph, that United is not required to pursue any claim of its own in an arbitration setting." (*Id.* at p. 1330.) Moreover, while the policy was

unilaterally imposed on employees, the corporation could modify it at any time without notice. (*Ibid.*)

In *Martinez, supra*, 118 Cal.App.4th 107 prospective employee Martinez indicated to the human resources representative that he preferred not to sign an arbitration agreement. He was told he could not work for the employer if he did not sign and accept it. In finding the arbitration clause procedurally unconscionable, the court cited not only the inequality of bargaining power, but also the absence of meaningful choice. (*Id.* at p. 114.)

The factual circumstances in which the *Flores, Kinney* and *Martinez* contracts were made provide additional grounds to support a finding of oppression apart from the bare fact that the contracts at issue were contracts of adhesion, as that term is defined in *Scissor-Tail* and *Neal.* (See fn. 1, *ante.*)

As I have noted, numerous appellate courts have defined the "oppression" component of procedural unconscionability more broadly than simply the presentation of an adhesive contract on a "take it or leave it" basis. ". . . [O]ur state's highest court recognized the point at which an adhesion contract becomes oppressive: 'In many cases of adhesion contracts, the weaker party lacks not only the opportunity to bargain but also *any realistic opportunity to look elsewhere for a more favorable contract*; he must either adhere to the standardized agreement *or forego the needed service.*'" (*Morris v Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1320, italics in original, quoting *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 669, 711 *(Madden).*[3])

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[3] *Villa Milano Homeowners Assn. v. Il Davorge* (2000) 84 Cal.App.4th 819, 827, took a different view of *Madden*, stating:

Dean Witter Reynolds, Inc. v. Superior Court (1989) 211 Cal.App.3d 758 (*Dean Witter*), for example, considered at length the availability of alternative sources of financial services in deciding whether "oppression" and unconscionability had been established to support an experienced investor's challenge under the Consumer Legal Remedies Act (CLRA; Civ. Code, § 1750, et seq.) to the contract governing his individual retirement account. The court rejected the investor's contention that availability of alternate sources is irrelevant to the adhesion analysis. ". . . [E]ven though a contract may be adhesive, the existence of "'meaningful'" alternatives . . . in the form of other sources of supply tends to defeat any claim of unconscionability as to the contract in issue." (*Dean Witter, supra*, 211 Cal.App.3d at p. 771.) While the investor's experience and sophistication were factually significant, the court held, "[The investor] was not shown to lack a meaningful choice with respect to the termination fee, and hence the 'oppression' factor of the procedural element of unconscionability was not established." (*Id.* at p. 772.)

In the case before us, these precedents inform my assessment of whether and to what extent the availability of alternative sources for the goods or service offered in an indisputably adhesive contract will avoid a finding that a challenged arbitration provision is procedurally unconscionable. No case has been cited to us which considered this precise issue. Only *Szetela, supra*, 97 Cal.App.4th at page 1100 appears to have considered the question in the context of determining the enforceability of an

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"[T]he court [in *Madden*] left open the possibility that, in a given case, a contract might be adhesive even if the weaker party could reject the terms and go elsewhere. [Citation.]"

arbitration clause in a contract for consumer goods or services.[4]

Szetela is factually similar to *Discover Bank*. A long-time bank cardholder received, in the form of a "bill stuffer," an amendment to his cardholder agreement that provided for mandatory arbitration and prohibited class arbitration. His choices were to accept the amendment or to close his account. *Szetela* specifically rejected the contention that the availability of a meaningful opportunity to obtain the offered goods or services elsewhere without the offending contract term "is the relevant test for unconscionability." (*Szetela, supra*, 97 Cal.App.4th at p. 1100.) "[W]hether Szetela could have found another credit card issuer who would not have required his acceptance of a similar clause is not the deciding factor." (*Id.* at p. 1100.) The court observed that procedural unconscionability focuses "on the manner in which the disputed clause is presented to the party in the weaker bargaining position. When the weaker party is presented the clause and told to 'take it or leave it' without the opportunity for meaningful negotiation, oppression, and therefore procedural unconscionability, are present. [Citation.] These are

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[4] In *Aral v. Earthlink, Inc.* (2005) 134 Cal.App.4th 544 (*Aral*) the terms of the services agreement for a digital subscriber line (DSL), including a class action waiver, were presented in what *Aral* characterized as a "'take it or leave it'" basis, either through the customer's installation of the software necessary to activate the DSL or through the materials included in the package in which the software was mailed to the customer "with no opportunity to opt out." (*Id.* at p. 557.) *Aral* concluded "[t]his is quintessential procedural unconscionability." (*Id.* at p. 557.) *Aral* does not assist in the resolution of the case before us because the issue of whether meaningful choices of DSL service were available to the customers was nowhere raised in *Aral*.

precisely the facts in the case before us. [Plaintiff] received the amendment to the Cardholder Agreement in a bill stuffer, and under the language of the amendment, he was told to 'take it or leave it.' His only option, if he did not wish to accept the amendment, was to close his account. We agree with [plaintiff] that the oppressive nature in which the amendment was imposed establishes the necessary element of procedural unconscionability." (*Ibid.*)

Read in its factual context, *Szetela* does not purport to dispense entirely with consideration of "absence of meaningful choice" in a procedural unconscionability analysis. Unlike the circumstances of the instant case, *Szetela* was conducting a procedural unconscionability analysis of a new adhesive condition imposed on an existing consumer agreement.

While the existence of a contract of adhesion is frequently the starting point for a procedural unconscionability analysis, adhesiveness and procedural unconscionability are discrete concepts. In my view, a contract of adhesion is not per se procedurally unconscionable. Even assuming the parties to the agreement do not have equal bargaining power, a realistic opportunity for the weaker party to avail him or herself of meaningful market alternatives can obviate oppression for purposes of procedural unconscionability. (*Wayne v. Staples, Inc.* (2006) 135 Cal.App.4th 466, 482; *Morris v. Redwood Empire Bancorp, supra*, 128 Cal.App.4th at p. 1320.) I do not disagree with *Szetela* that the availability of alternate sources of a product or service without binding the consumer to the objectionable class action waiver is not the "determinative" factor. (*Szetela, supra*, 97 Cal.App.4th at p. 1100.) But it is a relevant factor. Indeed, the greater the number of alternatives avail-

able to the consumer, the more bargaining power is shifted to the consumer. I do not suggest that the existence of marketplace choice altogether negates the oppression aspect of procedural unconscionability. The extent and significance of meaningful alternatives must be assessed in the light of the particular circumstances of each transaction. Analyzed in this light, I conclude the service agreement herein has not been shown to be procedurally unconscionable.

As T-Mobile argues, and plaintiffs do not dispute, when plaintiffs entered into their service agreements with T-Mobile, two other nationwide wireless telephone companies, Nextel and Sprint, had service agreements that did not contain a class action waiver provision, and, in the case of Nextel, no arbitration agreement at all.[5]

Furthermore, this agreement was presented to the customer at the time of the initial purchase, and, even after the purchase, the customer had a 14-day return period from date of activation, or a 30-day return period from date of purchase if not activated. These facts distinguish it from *Szetela* and *Discover Bank*, in which the bank sent their existing bank-

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[5] See majority, page 12, footnote 6. The referenced "third consolidated amended" complaints against Nextel and Sprint in the coordinated proceeding and the attached service agreements are in the record on appeal. Because plaintiffs failed to respond to T-Mobile's contention asserted in the trial court and on appeal that alternative sources were available, I would view the point as conceded. (*Fisher v. Gibson* (2001) 90 Cal.App.4th 275, 283-284.) Rather, plaintiffs' opposition to T-Mobile's motion to compel in the trial court and its arguments on appeal presumed that plaintiffs' allegations of a "contract of adhesion" describe "maximum procedural unconscionability" under California law. I believe California law provides otherwise.

card customers a mandatory arbitration/class action waiver provision as a "bill stuffer" addendum to their existing service agreements and forced the customers either to accept the new terms or to cancel their established accounts. While the T-Mobile customers may not have been able to negotiate the arbitration/class action waiver provision in the service agreement as part of their purchase negotiation, they were not confronted with a post-purchase choice of either accepting a more restrictive clause to an extant agreement, or foregoing entirely the service they had originally agreed to and enjoyed.

As *Armendariz, supra*, 24 Cal.4th 83 and other decisions make plain, adhesive contracts of employment present very different policy considerations from the adhesive consumer contract for a service such as a cell phone. Employment contracts that contain mandatory arbitration clauses are especially susceptible to being oppressive because "in the case of preemployment arbitration contracts, the economic pressure exerted by employers on all but the most sought-after employees may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement." (*Id.* at p. 115; see also *Little, supra*, 29 Cal.4th at p. 1071; *Independent Assn. of Mailbox Center Owners, Inc. v. Superior Court* (2005) 133 Cal.App.4th 396, 410: franchise agreements akin to employment contracts because franchisees' livelihoods are involved; *Fitz v. NCR Corp.* (2004) 118 Cal.App.4th 702, 722 (*Fitz*).)

Nothing like the economic pressure of obtaining or retaining employment is present in this case. However useful, convenient, or necessary cell phones

may be, they are qualitatively different from the offer of a job, or the offer of continued employment (see *Fitz, supra*, 118 Cal.App.4th at p. 722), or the imposition of a more restrictive policy to an existing employment (see *Kinney v. United Health Care Services, Inc., supra*, 70 Cal.App.4th 1322) or after one has accepted employment *(Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519, 1534), for which the job seeker or employee has no realistic alternative. An employee who has no opportunity to negotiate an employer's mandatory arbitration clause in the employment contract is limited to agreeing to the clause or forfeiting a paycheck and livelihood, and often crucial attendant benefits such as health care insurance or an employer sponsored pension program. Here, the contract at issue concerned a non-unique consumer good—mobile phone service—available new and used from several sources. There was no evidence that plaintiffs were unaware of the existence of other cell phone providers or that the services of the other providers were not available to them.

Notwithstanding the imbalance in the bargaining power between T-Mobile and its cell phone subscribers, plaintiffs have not persuaded me there is procedural unconscionability in the making of the service agreement. Plaintiffs were fully apprised of the terms of the service agreement, and they did not present evidence of lack of meaningful alternative sources or other arrangements to meet their cellular telephone needs. In these circumstances, T-Mobile's conduct cannot be deemed oppressive.

As I stated at the outset, the *Arrnendariz* analytic framework requires *both* procedural and substantive elements before a court can exercise its discretion to refuse to enforce a contract under the unconscion-

ability doctrine. (*Armendariz, supra*, 24 Cal.4th at p. 114; see also *A&M Produce, supra*, 135 Cal.App.3d at p. 487.) Because there is an absence on this record of both the surprise and oppression factors of procedural unconscionability, the service agreement is not unconscionable, and T-Mobile's motion to compel arbitration should be granted.

Jones, P.J.

APPENDIX B

SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA

[Filed SEP. 7, 2005]

J.C.C.P. 4332

In re: CELLPHONE TERMINATION FEE CASES

Date: August 30, 2005
Time: 10:00 am
Dept.: 22

ORDER DENYING MOTION OF T-MOBILE TO COMPEL ARBITRATION AND STAY PROCEEDINGS.

The motion of Defendant T-Mobile to Compel Arbitration came on for hearing on August 30, 2005, in Department 22 of this Court, the Honorable Ronald M. Sabraw presiding. Counsel appeared on behalf of Plaintiffs and on behalf of Defendants. After consideration of the points and authorities and the evidence, as well as the oral argument of counsel, IT IS ORDERED as follows: Motion of T-Mobile to Compel Arbitration and Stay Proceedings is DENIED.

ARBITRATION CLAUSE OVERVIEW

Plaintiffs are subscribers to T-Mobile and are parties to the arbitration agreement. The Arbitration Agreement was sent to the plaintiffs as part of a form contract. The essential terms of the Arbitration Agreement are:

1. All claims must be submitted to arbitration.
2. For claims under $25 the consumer will pay no arbitration fees.
3. For claims of between $25 and $1000 the consumer will pay an arbitration fee of $25.
4. For claims of over $1000 the consumer will pay half of the arbitration fees.
5. There will be no consolidation of claims in arbitration (class arbitration) and consumers may not participate in any class action.
6. If the waiver of class or representative claims is unenforceable, then the arbitration agreement will not apply and the dispute will be resolved in court.

WAIVER OF RIGHT TO COMPEL ARBITRATION.

The Court finds that T-Mobile has not waived its right to move to compel arbitration.

Until recently, it would have appeared to T-Mobile that a motion to compel arbitration would have been futile, so T-Mobile cannot be faulted for failing to file a petition to compel arbitration. *Letizia v. Prudential Bache Secur., Inc.* (9th Cir. 1986), 802 F.2d 1185, 1187, states, "there could be no waiver here because there was no existing right to arbitration. . . . [D]efendants here correctly perceived that a motion to compel arbitration would have been futile because of the apparent intertwining of arbitrable and nonarbitrable claims. . . . Clearly, then, there was no existing right to arbitrate when this suit was filed. Thus, there could have been no waiver."

In addition, plaintiffs have not suffered prejudice from T-Mobile's delay in seeking to compel arbi-

tration. To the contrary, Plaintiffs have obtained discovery that may be of use in the F.C.C. proceeding and would be of use if the case were to proceed to arbitration.

LEGAL STANDARD.

T-Mobile asserts that the arbitration provision is enforceable under the Federal Arbitration Act and under California Law. Plaintiffs assert that the arbitration provision is unconscionable and cannot be enforced.

Consistent with *Discover Bank v. Superior Court* (2005) 36 Cal. 4th 148, the Federal Arbitration Act, and the California Arbitration Act, the Court applies the unconscionability analysis for contracts generally and does not hold the arbitration agreement to a different standard.

The unconscionability analysis is framed by *Armendariz v. Foundation Health Physicare Services, Inc.* (2000) 24 Cal. 4th 83. Under *Armendariz*, unconscionability has a procedural and a substantive component. In order for a finding of unconscionability to be made, both components must be present. However, the two components operate on a sliding scale; the greater the procedural showing, the less is required from a substantive perspective, and vice versa. *Armendariz*, 24 Cal. 4th 83, at 114.

The determination of whether a contract or a clause in a contract is unconscionable is a mixed question of law and fact that is determined by the trial court. Addressing the standard of review, *Ilkhchooyi v. Best* (1995) 37 Cal. App. 4th 395, 411, states, "Unconscionability is ultimately a question of law. In determining whether the trial court's determination of unconscionability was correct, "we

must assume a set of facts consistent with the [trial] court's finding of unconscionability if such an assumption is supported by substantial evidence.'" But see *Freeman v. Wal-Mart Stores, Inc.* (2003) 111 Cal. App. 4th 660, 669-670 ("trial court did not abuse its discretion in finding the shopping card fee term not unconscionable.").

INJUNCTIVE RELIEF.

Cruz v. PacificareHealth Systems, Inc. (2003) 30 Cal.4th 303, and *Broughton v. Cigna Healthplans* (1999) 21 Cal. 4th 1066, expressly hold that claims seeking injunctive relief primarily for the benefit of the public are not subject to arbitration.

In *State v. Altus Finance* (2005) 2005 Cal. LEXIS 8909, page *47, the Court recently took note that there can be a significant distinction between claims seeking injunctive relief primarily for the benefit of the public and claims seeking injunctive relief primarily to rectify individual wrongs. Both *Cruz* and *Broughton* expressly declined to address whether claims seeking injunctive relief primarily to rectify individual wrongs were subject to arbitration. *Cruz*, 30 Cal.4th at 315; *Broughton*, 21 Cal.4th at 1080, fn 5.

In the event it may be relevant to appellate review, the Court finds that this is a putative class action and that the putative class appears to include a large number of California residents. Where the interests of a large number of persons are implicated, the Legislature and the Courts have suggested that the aggregated interests of many individuals is similar to the interest of the general public. C.C.P. 1021.5 (Court may award attorneys' fees where a case has conferred a significant benefit "on the general public

or a large class of persons"); *Discover Bank v. Superior Court* (2005) 36 Cal. 4th 148, 156-158 (discussing public benefits of class actions). Therefore, the Court holds that the claims for injunctive relief in this case are primarily for the benefit of the public and that as a result they are not subject to arbitration.

MONETARY RELIEF.

PROCEDURAL COMPONENT.

The context in which the T-Mobile arbitration clause was presented to consumers has some indications of procedural unconscionablility, but these indications are not particularly strong. *Discover Bank*, 36 Cal. 4th 160-161, states that an element of procedural unconscionability is present when a consumer is given an amendment to its cardholder agreement in the form of a "bill stuffer," but that adhesive contracts are generally enforced. In this case the arbitration clause is paragraph 3 of the consumer agreement and is in capital letters. The contract containing the clause is provided with the phone and accepted by use of the phone. The use of a form contract and the acceptance of a contract by using the product are not per se unconscionable.

SUBSTANTIVE COMPONENT—GENERAL DISCUSSION.

The law on the enforceability of waivers of class actions and arbitrations was discussed recently in *Discover Bank v. Superior Court* (2005) 36 Cal. 4th 148, and the recently vacated *Parrish v. Cingular Wireless* (2005) 129 Cal. App. 4th 601. The discussion in *Discover Bank* is technically dicta, but dicta from the Supreme Court is persuasive. *Rodrigo v. Koryo*

Martial Arts (2002) 100 Cal. App. 4th 946, 956 fn 3 ("Dictum of the Supreme Court, while not controlling, carries "persuasive weight" and should be followed when it demonstrates either "a thorough analysis of the issue" or "compelling logic.""). *Parrish* has been vacated and is not authority. The Court observes that *Discover Bank* and *Parrish* approach the issue of whether class action waivers are unconscionable from different perspectives.

Parrish considered whether it would be unconscionable to impose the arbitration clause on the individual consumer. *Parrish* reasoned that the arbitration clause permitted individual consumers access to small claims court and that small claims court is designed to be an easy and low cost means to resolve disputes over small amounts of money. *Parrish* then concluded that because consumers have access to small claims court, the arbitration clause was not unconscionable because consumers have an effective means to resolve their disputes. Under this individual consumer-centric approach, a finding that the arbitration clause was unconscionable would be equivalent to a judicial finding that small claims court is an ineffective forum for small claims. *Parrish* held that the Attorney General, District Attorneys, and other officials could protect the larger interests of the general public through law enforcement actions.

Discover Bank considered whether it was contrary to California public policy for the corporate defendant to impose the arbitration clause on consumers. *Discover Bank's* analysis is not based on whether a contract term is unconscionable as to any given individual consumer, but rather whether the contract term provides an improper benefit to the corporate

defendant (in the case of *Discover Bank*, an exculpatory clause) and is therefore against public policy.

Discover Bank starts with a discussion of the justifications for class action suits. The Court notes that class actions exist for several reasons—to ease the burden on individual plaintiffs of filing individual lawsuits, to ease the burden on the Courts of considering multiple lawsuits, and (presuming that the burden of filing individual lawsuits would lead to fewer lawsuits) to deter defendants from engaging in unlawful activities and to ensure that they do not retain the benefits of those activities.

Because individual arbitration may impose less of a burden on claimants than small claims court and shifts the burden of considering multiple individual clams from the Courts to private arbitrators, the primary focus of the of *Discover Bank's* public policy analysis is on how a requirement for individual arbitration would affect the defendant. *Discover Bank* observes the deterrent effect of class actions and states, "A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices," 36 Cal.3th at 156; "the class action is often the only effective way to halt and redress . . . exploitation. [Judicial policy does not] permit the defendant to retain the benefits of its wrongful conduct and to continue that conduct with impunity," 36 Cal.3th at 156; and "Denial of a class action in cases where it is appropriate may have the effect of allowing an unscrupulous wrongdoer to 'retain[] the benefits of its wrongful conduct," 36 Cal.3th at 157. The Court of Appeal for the First District recently observed the same public benefits in *Bell v. Farmers Ins. Exchange* (2004) 115 Cal. App. 4th 715, 741,

where it stated, "the class action not only benefits the individual litigant but serves the public interest in the enforcement of legal rights and statutory sanctions."

Discover Bank then discusses the enforceability of class action waivers. In this section the Court appears to make the distinction between unconscionability and public policy when it states, "[*Keating*] did not answer directly the question whether a class action waiver may be unenforceable as contrary to public policy or unconscionable." 36 Cal.3th at 158. Thereafter, although *Discover Bank* uses the term "unconscionability," it discusses public policy. There is little to no discussion in *Discover Bank* about whether the requirement for individual arbitration is an unconscionable term in the contract between the defendant and the individual consumer. Any such discussion would need to confront the issue of how, to reconcile (1) the fact that individual arbitrations can be easier than or equivalent to small claims court and (2) the presumption that small claims court is an effective means to resolve small claims. The focus in *Discover Bank* is on whether the prohibition on class actions and class arbitration violates a public policy.

The *Discover Bank* analysis could be framed in terms of the unconscionability of individual contracts if one views a form consumer contract as a single contract. The substantive unconscionability analysis concerns whether a contract is "one sided." Although each individual consumer is concerned only with his or her individual contract, the corporation that does business with thousands of consumers is concerned about its business in the aggregate. Therefore, although the customers of a corporation may have

thousands of contracts with the corporation, the corporation effectively has only one contract with its thousands of customers. As a result, when determining whether a contract is "one sided," it is significant whether one views the issue from the side of an individual consumer or the side of the corporation. *Discover Bank* examines whether a contract is "one-sided" from the perspective of what the corporation obtains in a single form contract and not from the perspective of what each individual consumer gives up in his or her individual contract.

Discover Bank's discussion of public policy and unconscionability is based primarily on Civil Code 1668, which states, "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." *Discover Bank* also relies on *Szetela's* analysis of how public policy of Civil Code 1668 applies to waivers of class actions and arbitration. *Szetela* states, "Discover has instead sought to create for itself virtual immunity from class or representative actions despite their potential merit, while suffering no similar detriment to its own rights. . . . Discover has essentially granted itself a license to push the boundaries of business practices to their furthest limits, . . . Therefore, the provision violates fundamental notions of fairness: . . . This is not only substantively unconscionable, it violates public policy by granting Discover a 'get out of jail free' card while compromising important consumer rights.'" 97 Cal.App.4th at 1101.

Discover Bank observes that although "[c]lass action and arbitration waivers are not, in the

abstract, exculpatory clauses" . . . "they operate to insulate a party from liability that otherwise would be imposed under California law" and are therefore against public policy. 36 Cal.4th at 161. The effective insulation from liability is because consumers presumably will not pursue valid claims unless the claim is worth more than the time and effort needed to fill out a complaint, serve the complaint, collect evidence, and attend the trial. This effort can be significant for persons with time commitments to their families, friends, jobs, and communities. See *Szetela*, 97 Cal.App.4th at 1101 (Suggesting that defendant are [sic] "Fully aware that few customers will go to the time and trouble of suing in small claims court" and are "fully aware that relatively few, if any, customers will seek legal remedies.").

Based on these public policy considerations and its review of the benefits a defendant may obtain from a class action and arbitration waiver, *Discover Bank* concludes, "We do not hold that all class action waivers are necessarily unconscionable. But when the waiver is found in a [1] consumer contract of adhesion in [2] a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when [3] it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, . . . such waivers are unconscionable under California law and should not be enforced."

SUBSTANTIVE COMPONENT—
APPLICATION TO THIS CASE.

The Court reviews the factors identified in *Discover Bank* and holds that the prohibition on class arbitrations or participation in a class action in T-Mobile's contract is against public policy because it provides an improper benefit to the defendant.

The first factor requires little discussion—T-Mobile's contracts were with consumers and were Contracts of adhesion.

The second factor, the "setting," presents an important issue. It is unclear whether the "setting" is the discrete claim of the named plaintiff, the potential claims of the putative class members, or the circumstances of the defendant's relationship with all customers who are parties to the form contract. The Court finds that the "setting" refers to the circumstances of the defendant's relationship with all customers who are parties to the form contract. The commercial relationship must be the "setting" because under Civil Code 1670.5(a) the unconscionability of a contract is determined as of the time the contract was made and not with the benefit of knowing the circumstances and amount of any claim. *Discover Bank* confirms this approach because it states that the Court should consider whether *disputes* between the contracting parties *predictably* involve small amounts of damages rather than stating the Court should consider whether *the dispute* between the contracting parties *actually* involves small amounts of damages. Finally, it would be [sic] lead to unpredictable and inconsistent results if a class action and arbitration waiver in a contract was unconscionable for certain consumers with certain disputes but enforceable when other consumers

had other disputes. Where a standardized consumer contract is at issue, the enforceability of an arbitration clause should not turn on the vagaries of the specific nature of the claim (collect calls, improper charges, improper accounting methods, ETFs, etc.) or the amount of the claim by the named plaintiff (which could change depending on who represented a class). The Court therefore, examines the setting of T-Mobile's contractual relationship with its consumers and does not limit its inquiry to the specific nature and amount of the claims by the named plaintiffs.

The definition of "small amounts" also presents important issues. *Discover Bank* did not provide clear guidance on what constitutes a "small amount" other than to suggest that $29 is a small amount. Individual claims in class actions of a few dollars per person in consumer cases would appear to meet the criteria, whereas individual claims in class actions alleging fraud or statutory violations in the sale of houses, cars, or other big-ticket consumer items may not meet the criteria. Compare *State of California v. Levi Strauss & Co.* (1986) 41 Cal. 3d 460, 464 ("an average individual recovery of $2.60-$3.") with *Hicks v Kaufman & Broad Home Corp.* (2001) 89 Cal. App. 4th 908 (class action concerning house foundations). It is also unclear whether the Court is to view the "small amount" as an absolute number in proportion to the value of the good or service at issue, or as relative to the wealth of the plaintiff class. The Court does not resolve these interesting questions.

The Court finds that T-Mobile's provision of telephone serves [sic] to individual consumers typically involves the sale of telephones for $30-$300 per phone, calling plans of $20-$130 per month, addi-

tional charges of $0.40 per minute, early termination fees of $200, and other fees and charges. The Court makes this finding based on the record in this case. The Court also takes judicial notice of T-Mobile's website regarding its National Rate Plans and related web screens. (Attached to this order.) The terms of T-Mobile's contracts with its consumers are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy. Evid. Code 452(h). These findings support the conclusion that the setting of T-Mobile's contractual relationship with its consumers predictably involves disputes over small amounts of damages.

Third, Plaintiffs allege that T-Mobile has enforced contracts and seeks to enforce contracts that have and would unlawfully impose ETF charges of $200 on large numbers of consumers. Plaintiffs might not allege that T-Mobile tries to "deliberately cheat" its customers, but the effect is the same.

Based on these findings, and following *Discover Bank* and *Szetela v. Discover Bonk* (2002) 97 Cal. App. 4th 1094, the Court holds that the class action and class arbitration waiver in T-Mobile's form consumer contract provides it with an improper benefit and is contrary to California's public policy.

The arbitration clause states that if the waiver of class or representative claims is unenforceable, then the arbitration clause will not apply and the dispute will be resolved in court. Therefore, the Court does not need to address whether classwide arbitration is an option.

By way of dicta, the Court observes that in many class actions there is a trial on the common issue of

liability (the liability phase) followed by an individualized claims procedure or individual hearings to determine or allocate, the damages (the remedial phase). See *Sav-On Drug Stores, Inc. v. Superior Court* (2004) 34 Cal. 4th 319, 339 fn 12 (discussing procedural options); *City of San Jose v. Superior Court* (1974) 12 Cal. 3d 447, 466 (Tobriner dissent) ("Perhaps the trial court could devise a procedure under which a joint trial on the common issues of law and fact would be followed by individual or subclass hearings on diverse issues."); *Cooper v. Federal Reserve Bank* (1984) 467 U.S. 867, 876 ("While a finding of a pattern or practice of discrimination itself justifies an award of prospective relief to the class, additional proceedings are ordinarily required to determine the scope of individual relief for the members of the class."). There might not be any material difference between a two phase class action with a trial on liability followed by individual hearings on damages and a one phase class action trial on the merits to determine public injunctive relief followed by notice to class members of their ability to seek monetary relief through arbitration. The Court makes this observation because it suggests although *Discover Bank* held that corporations may not effectively insulate themselves from liability by requiring individualized arbitrations, trial judges retain the discretion to use a two phase class action procedure and require individualized hearings to determine the amount of monetary relief due to the class members.

Given that the *Discover Bank* analysis is new and that parties did not directly address some of the issues in this order, the Court will permit T-Mobile to file a motion for reconsideration on or before September 16, 2005, for the purpose of presenting

new argument and evidence, *Le Francois v. Goel* (2005) 35 Cal. 4th 1094 (Court may invite reconsideration); *Bacon v. Southern Cal. Edison Co.* (1997) 53 Cal.App.4th 854, 860 (Court should not resolve motion on issue not briefed by the parties).

Dated: 9/6/05

/s/ Ronald M. Sabraw
RONALD M. SABRAW
JUDGE OF THE SUPERIOR COURT

APPENDIX C

IN THE SUPREME COURT OF CALIFORNIA
En Banc

[Filed OCT. 10, 2007]

S154947

Court of Appeal
First Appellate District, Div. 5
Nos. A112082/A112084

BRUCE GATTON *et al.*,
Plaintiffs and Respondents,

v.

T-MOBILE USA, INC.,
Defendant and Appellant.

AND COMPANION CASE

The petition for review is denied.

/s/ George
Chief Justice

APPENDIX D

T-MOBILE TERMS AND CONDITIONS

* * * *

3. Mandatory Arbitration: Dispute Resolution. YOU WILL FIRST NEGOTIATE WITH US IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND US IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES, OR UNITS ("CLAIM"). YOU MUST SEND A WRITTEN DESCRIPTION OF YOUR CLAIM TO OUR REGISTERED AGENT (See Sec. 22). IF YOU DO NOT REACH AGREEMENT WITH US WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION WITH THE AMERICAN ARBITRATION ASSOCIATION ("AAA") UNDER ITS PUBLISHED WIRELESS INDUSTRY ARBITRATION RULES, WHICH ARE A PART OF THE AGREEMENT BY THIS REFERENCE AND ARE AVAILABLE BY CALLING THE AAA AT 800-778-7879 OR VISITING ITS WEB SITE AT www.adr.org. You must serve our registered agent (See Sec. 22) with a notice of an arbitration in order to begin an arbitration. This agreement to arbitrate extends to claims that you assert against other parties, including without limit equipment manufacturers and dealers, if you also assert claims against us in the same proceeding. The Agreement involves interstate commerce and despite the choice of law provision in Sec. 25, the Federal Arbitration Act and federal arbitration law govern arbitrations under the Agreement. An arbitrator may only award as much relief as a court having jurisdiction in the place of arbitration, limited to the same extent that a

court would limit such relief and consistent with the provisions of the Agreement. An arbitrator may order injunctive or declaratory relief (so long as that injunctive or declaratory relief does not apply beyond your dealings with us) or summary judgment under applicable law. AAA has a fee schedule for arbitrations. You will pay your share of the arbitrator's fees except: (a) for claims less than $25, we will pay all arbitrator's fees and (b) for claims between $25 and $1000, you will pay $25 for the arbitrator's fee. You and we agree to pay our own other fees, costs and expenses including those for counsel, experts, and witnesses. Visit www.adr.org arbitrator fee information in hardship circumstances.

Neither you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated or otherwise determined in one proceeding. While the prohibition on consolidated or classwide proceedings in this Sec. 3 will continue to apply: (a) you may take claims to small claims court, if they qualify for hearing by such court and (b) if you fail to timely pay amounts due, we may assign your account for collection and the collection agency may pursue such claims in court limited strictly to the collection of the past due debt and any interest or cost of collection permitted by law or the Agreement. YOU AND WE ACKNOWLEDGE AND AGREE THAT THIS SEC. 3 WAIVES ANY RIGHT TO A JURY TRIAL OR PARTICIPATION AS A PLAINTIFF OR AS A CLASS MEMBER IN A CLASS ACTION. IF A COURT OR ARBITRATOR DETERMINES THAT YOUR WAIVER OF YOUR ABILITY TO PURSUE CLASS OR REPRESENTATIVE CLAIMS IS UNENFORCEABLE, THE ARBITRATION AGREEMENT WILL NOT APPLY

AND OUR DISPUTE WILL BE RESOLVED BY A COURT OF APPROPRIATE JURISDICTION, OTHER THAN A SMALL CLAIMS COURT.

* * * *

1/13/2004

* * * *

No. 07-1036

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SUPREME COURT, U.S.

In The
Supreme Court of the United States

T-MOBILE USA, INC.,

Petitioner,

vs.

BRUCE GATTON, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of The State Of California, First Appellate District, Division Five

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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STATEMENT OF THE CASE

The appellate decision below arose out of coordinated litigation pending in the Alameda County (California) Superior Court. In that litigation, respondents allege that T-Mobile imposes early termination fees on its cellular telephone subscribers in a manner inconsistent with provisions of California law. Respondents Christina Nguyen and Adrianne Grant also challenge T-Mobile's practice of locking its cellular telephone handsets to prevent those handsets from being activated on the networks of other compatible carriers. Respondents assert, *inter alia*, state law consumer protection claims on behalf of classes of current and former subscribers to T-Mobile service.

In July 2005, nearly two years after this action commenced, T-Mobile filed a motion to compel arbitration of all claims asserted against it by respondents. On September 7, 2005, the Superior Court denied that motion, finding that T-Mobile's arbitration provisions were procedurally and substantively unconscionable under California law and therefore unenforceable. Pet. App. 50a-60a.

On June 22, 2007, relying on *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005), the California Court of Appeal affirmed the Superior Court's ruling that T-Mobile's arbitration provision was unconscionable and therefore unenforceable under California law. Pet. App. 8a-24a. The Court of Appeal also rejected T-Mobile's argument that the Federal Arbitration Act preempted the rule that class action

waivers are unconscionable under California law under some circumstances. *Id.* at 24a-27a.

On August 1, 2007, T-Mobile filed a petition for review with the California Supreme Court. The California Supreme Court denied review on October 10, 2007. Pet. App. 61a.

I. THE COURT SHOULD DENY THIS PETITION, NOT HOLD IT PENDING DISPOSITION OF THE UNRELATED PETITION IN *LASTER*, BECAUSE THE ISSUES RAISED ARE DIFFERENT AND NEITHER CASE IS SUITABLE FOR THIS COURT'S REVIEW

T-Mobile's sole request for relief from this Court is that this petition be held "pending the Court's disposition of *T-Mobile USA, Inc. v. Laster*, No. 07-976 (filed Jan. 23, 2008), and then disposed of accordingly." Petition at 11. T-Mobile states the "Question Presented" by this petition as "[w]hether this petition for certiorari should be held pending this Court's disposition of the petition for certiorari previously filed in [*Laster*] . . . " Petition at (i). T-Mobile argues that the "issue presented in this case is the same as the one squarely presented in" the *Laster* petition (*id.* at 10), and that the Court should grant the *Laster* petition, while holding this case until resolution of that one. *Id.* at 10-11.

However, petitioner ignores an important distinction between the question raised by the *Laster* petition and the ruling below in this case: *Laster* is a

petition from a ruling of a federal Court of Appeals, while this case involves a ruling by a middle level state appellate court. This is an important and possibly outcome-determinative distinction. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006) (Thomas, J., dissenting) (reiterating view that the Federal Arbitration Act does not apply to proceedings in state court).

The *Laster* petition itself recognizes the importance of the identity of the court in which an FAA preemption question arises. The "question presented" in that petition (drafted by the same counsel, on behalf of the same party, as this petition) is explicitly phrased to focus attention on the status of the court below as within the federal judicial system: "Whether, under the Federal Arbitration Act, *a federal court* may refuse to enforce the terms of an agreement to arbitrate based upon a state-law policy that individual arbitration is unconscionable in cases involving small claims by a consumer." Petition For a Writ of Certiorari, No. 07-976, at (i) [emphasis added]. Resolution of *that* question will not govern the result in this state court case.

Nor should the Court consider accepting this petition on its merits. Every prudential consideration weighs against review. The decision below was issued by a state intermediate appellate court. The case remains on-going at the trial court level, with no final judgment and this Court's jurisdiction is doubtful. *See* 28 U.S.C. §1257 (vesting jurisdiction in this Court to review "final judgments or decrees rendered by the

highest court of a State"). Moreover, it is part of a cluster of consolidated, related cases involving extensive and complex prior procedural rulings. Pet. App. 2a, n. 1, 5a-7a; *see also*, *Meoli v. AT&T Wireless Servs.*, 2005 Cal. App. Unpub. LEXIS 8994 at *1-*6 (Cal. Ct. App. 2005). As T-Mobile admits, such a case is not an ideal candidate for this Court's consideration of the issue raised by the Petition. Petition at 10-11.

In addition, the specific wording of T-Mobile's arbitration provision makes this case (and, for that matter, the *Laster* case which involves the identically-worded language) a poor vehicle to address any preemption issue under the Federal Arbitration Act. First, T-Mobile's arbitration agreement includes language *repudiating* arbitration if any court or arbitrator finds that the agreement's prohibition on class action procedures is unenforceable. Pet. App. 63a-64a; Pet. App. in *Laster* 37a-38a.[1] It is solely because of this language, drafted by T-Mobile, that the trial court below denied outright T-Mobile's motion to compel rather than sending the case to arbitration, potentially on a classwide basis. Pet. App. 58a. The orders of the courts below neither evidenced "hostility" to arbitration nor ordered a dispute resolved in a

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[1] "If a court or arbitrator determines that your waiver of your ability to pursue class or representative claims is unenforceable, the arbitration agreement will not apply and our dispute will be resolved by a court of appropriate jurisdiction, other than a small claims court." *Id.* (capitalization omitted).

judicial forum which the parties had agreed to be resolved in an arbitration. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989). Instead, after applying generally applicable California law precluding contractual bans on class actions in small claim cases, the courts below *implemented* the contractual demand by T-Mobile that the action proceed in court, not arbitration.

Second, as explained in the *amicus* brief filed by AT&T Mobility in the *Laster* case, T-Mobile's arbitration provision is unclear on a customer's entitlement to recover attorneys fees after prevailing in arbitration. Brief Of AT&T Mobility LLC As Amicus Curiae In Support Of Neither Party, filed in No. 07-976, at 19-21. T-Mobile assumes in its petition in *Laster* that its arbitration language allows for such an award of attorneys fees (*Laster* Petition at 13) and cites cases finding the prevailing party's right to recover fees to be a relevant factor in determining enforceability of an arbitration provision (*id.* at 21-22). Definitive construction of the language in question would be required to address T-Mobile's arguments in these petitions. In neither this case, nor *Laster*, however, have the lower courts yet interpreted the scope and meaning of the language at issue.

II. THE COURT SHOULD DENY THE PETITION IN *LASTER* AS WELL AS THIS PETITION

Because T-Mobile asks the Court to hold this petition pending resolution of the *Laster* petition, we address the reasons why the Court should not accept the *Laster* case, and perforce this case, for review.

A. The Decision In *Laster* And The California Cases On Which It Relied Present No Threat To The Continued Vigorous Implementation Of The FAA's Policy Favoring Enforcement Of Arbitration Agreements

T-Mobile contends that the Ninth Circuit's decision in the *Laster* case, and similar decisions by other state and federal courts, pose a dire threat to the policy stated in the Federal Arbitration Act, as construed by this Court, favoring enforcement of arbitration agreements. T-Mobile characterizes these decisions as refusing to honor the parties' pre-dispute contractual choice of arbitration rather than litigation and suggests that they will lead to widespread migration of business/consumer cases from an arbitration forum to a judicial forum. *Laster* Petition 12-14. These contentions do not withstand scrutiny.

The policy of the State of California, like that embodied in the FAA, favors enforcement of arbitration agreements. *Wagner Construction Co. v. Pacific Mechanical Corp.*, 41 Cal.4th 19, 25, 157 P.3d 1029

(Cal. 2007) (California Arbitration Act represents a "strong public policy in favor of arbitration"); *Moncharsh v. Heily & Blase*, 3 Cal.4th 1, 9, 832 P.2d 899 (Cal. 1992) (same).[2] Indeed, California's pro-arbitration policy *pre-dates* passage of the FAA by Congress in 1925. *See, e.g., Utah Const. Co. v. Western Pac. Ry. Co.*, 174 Cal. 156, 159, 162 P. 631 (Cal. 1916) ("The policy of the law in recognizing arbitration agreements and in providing by statute for their enforcement is to encourage persons who wish to avoid delays incident to a civil action to obtain an adjustment of their differences by a tribunal of their own choosing."). Thus, any suggestion that either California's Legislature or its courts are generally hostile to arbitration or the goals of the FAA is clearly unwarranted.

California also has a strong public policy against exculpatory contractual provisions. California Civil Code section 1668 provides: "All contracts which have for their object, *directly or indirectly*, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." (Emphasis added.) This statute has represented the State's policy since 1872,

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[2] Echoing Section 2 of the FAA, Cal. Code of Civil Procedure section 1281 provides: "A written agreement to submit to arbitration an existing controversy or a controversy thereafter arising is valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract."

when it was enacted. Where the small size and/or large cost associated with a particular claim render individual adjudication economically impractical, a contractual provision requiring such individual adjudication is unenforceable under the California statute. *America Online, Inc. v. Superior Court*, 90 Cal.App.4th 1, 108 Cal. Rptr. 2d 699 (Cal. Ct. App. 2001). This application of the state policy against exculpatory clauses has nothing whatever to do with arbitration – rather, it is an implementation of the generally applicable rule that contractual waivers of class or group adjudication are unenforceable *if* they act as the essential equivalent of an exculpatory clause. *Id.* at 17-18 (contractual forum selection clause unenforceable because honoring it would preclude consumer class action; no arbitration clause at issue).[3]

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[3] The recognition by the California courts that the absence of class action procedures will effectively preclude recovery for aggrieved persons with small claims in some circumstances is long-held. *Blue Chip Stamps v. Superior Court*, 18 Cal.3d 381, 387, 556 P.2d 755 (Cal. 1976) (Tobriner, J., concurring) ("A company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit; the class action is often the only effective way to halt and redress such exploitation.").

This Court has come to the same conclusion on numerous occasions. *See, e.g., Amchem Products, Inc. v. Windsor* 521 U.S. 591, 617 (1997) ("'The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.'");

(Continued on following page)

Despite T-Mobile's arguments otherwise, the California judicial decisions, which the Ninth Circuit in *Laster* and *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007) followed when applying California law in those diversity cases, did not invalidate the parties' choice of arbitration over litigation. Instead, the California Supreme Court expressly stated its intention to *enforce* the contractual requirement that the parties arbitrate their disputes in those cases – invalidating only the portion of the contractual language which was contrary to the generally-applicable contract doctrine described above. *Gentry v. Superior Court*, 42 Cal.4th 443, 451 (Cal. 2007) (classwide *arbitration* of employees' statutory labor claims allowed if individual arbitration found infeasible; declining to hold that all class action waivers in employment contracts are unenforceable); *Discover Bank v. Superior Court*, 36 Cal.4th 148, 152-153 (Cal. 2005) (consumer plaintiff entitled to pursue classwide *arbitration* despite language in arbitration clause requiring individual arbitration proceedings).

For that reason, the rulings by the Ninth Circuit in *Laster* and the California courts below in the instant case would have been to send *these* cases to

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Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 339 (1980) ("Where it is not economically feasible to obtain relief within the traditional framework of a multiplicity of small individual suits for damages, aggrieved persons may be without any effective redress unless they may employ the class-action device.").

arbitration (with the potential for classwide prosecution) but for one fact – as noted above, T-Mobile's own contract language precluded it. It is thus T-Mobile's own distrust of arbitration in representative actions that has left these cases in a litigation rather than arbitration mode. While T-Mobile is presumably free to elect to forgo arbitration for that category of cases by so phrasing its contracts with its customers, it cannot credibly contend that it is its customers who are the "anti-arbitration" parties in this dispute. Following this Court's decision in *Green Tree Financial Corporation v. Bazzle*, 539 U.S. 444 (2003), the major arbitration providers have enacted rules to handle such cases and class arbitrations have become relatively common. The largest provider, the American Arbitration Association, currently lists 227 class arbitrations on its website.[4] And this Court has consistently rejected any argument that arbitrators are inherently less capable of resolving complex, large-scale disputes than are the courts. *Shearson/American Express v. McMahon*, 482 U.S. 220, 239 (1987) (RICO claims subject to arbitration); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 633 (1985) (international antitrust dispute suitable for arbitration; "potential complexity should not suffice to ward off arbitration").

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[4] http://www.adr.org/sp.asp?id=25563 and successive pages [last visited on April 17, 2008].

T-Mobile argues that the benefits of arbitration depend upon the ability to resolve claims relatively quickly through individual arbitration as opposed to an undoubtedly longer and more involved classwide arbitration. *Laster* Petition 4, 12-13. But this argument compares apples to oranges. While any *particular* customer claim might be resolved more expeditiously and at lower cost in an individual arbitration than in a classwide proceeding, the correct comparison is between the *total* cost and time commitment required to resolve the thousands or tens of thousands of customer claims in individual arbitration proceedings as opposed to one classwide proceeding. Obviously, the goals of efficiency and expediency are *furthered* not hindered by group adjudication. Similarly, T-Mobile presents no evidence, or even logic, to support any argument that classwide arbitration is not likely to be quicker and less expensive than class adjudication. The advantages of arbitration over litigation apply to class proceedings as well as individual ones.

T-Mobile's real reason for seeking to avoid class adjudication (whether in arbitration or in court) is precisely the one identified by the California courts as contrary to state public policy: The practical result of no classwide procedures for resolving these small claims is no resolution at all, thus effectively shielding T-Mobile from the wrongs alleged against it. This desire has nothing whatsoever to do with preference for arbitration; it has everything to do with attempting to avoid liability. T-Mobile used the mechanism of a pre-dispute arbitration clause as a vehicle to seek to

exculpate itself from liability for small value claims. The California decisions challenged herein have quite properly differentiated between the legitimate goal of resolving disputes in arbitration and the illegitimate goal (under State law) of contractually immunizing one's self from liability for violations of law. Other states may come to contrary conclusions under the state laws existing therein. However, California has long held a policy precluding such contractual immunization, whether sought to be achieved "directly or indirectly." Cal. Civil Code §1668.

B. T-Mobile's Contention That The *Gay* Case Presents A Conflict Justifying Grant Of The *Laster* Petition Is Not Well-Taken

T-Mobile relies heavily on the recent decision in *Gay v. Creditinform*, 511 F.3d 369 (3d Cir. 2007) which, T-Mobile asserts, has created a conflict among the Courts of Appeals on the question whether the FAA preempts a state law rule that class action bans in arbitration clauses are unconscionable. *Laster* Petition at 2-3, 18-20. On closer scrutiny, however, the *Gay* case presents no conflict worthy of this Court's review. Based on a contractual choice of law provision, the court held that the arbitration provision at issue was not unconscionable under Virginia state law. 511 F.3d at 390-392. While this was sufficient to dispose of the case, the court proceeded to address Pennsylvania law, which the plaintiff urged should be applied. The *dicta* relied upon by T-Mobile is based upon

the *Gay* court's questionable interpretation of two Pennsylvania state lower court decisions. The *Gay* court characterized these Pennsylvania decisions as running afoul of this Court's admonishment in *Perry v. Thomas*, 382 U.S. 483, 492 n. 9 (1987) that a state law contract defense to an arbitration clause must not be grounded in a unique attribute of arbitration itself. 511 F.3d at 395.

The *Gay* decision does not create a conflict worthy of this Court's attention for at least two reasons. First, the *Gay* court viewed Pennsylvania law as choosing judicial resolution over arbitral resolution of small value claim cases, because it interpreted the state decisions at issue as protecting the right to bring a class action in court in such situations. 511 F.3d at 393. If this was an accurate understanding of Pennsylvania law, that law differs dramatically from the California law at issue in *Laster* and this case. As previously discussed, California law *favors* arbitration and enforces arbitration agreements to the maximum extent possible by ordering small value cases covered by such agreements to class arbitration. The *Gay* decision never addresses the viability of a state law rule preferring class *arbitrations* to individual arbitrations where class resolution is the only practical way for consumers to vindicate their statutory rights. It certainly did not hold that such a preference would be preempted by the FAA. Nor would that court's logic make sense in the context of California law, where judicial decisions have applied the unconscionability doctrine at issue to contracts

without any arbitration clause at all, thus clearly undermining any suggestion that the state rule discriminates against arbitration or takes its meaning from the arbitration clause itself. *America Online, Inc., supra.*

Second, the *Gay* decision is quite recent and it is far from clear that it represents the view even of the Third Circuit itself. Both before and after *Gay*, the Third Circuit has issued decisions addressing FAA preemption which are completely consistent with that of the approach used by the Ninth Circuit in *Laster*, *Shroyer* and *Lowden v. T-Mobile USA, Inc.*, 512 F.3d 1213, 1221 n. 3 (9th Cir. 2008). *See*, *Zimmer v. Cooperneff Advisors, Inc.*, ___ F.3d ___, 2008 U.S. App. LEXIS 8357 (3d Cir. April 14, 2008); *Delta Funding v. Harris*, 426 F.3d 671 (3d Cir. 2005). In both of those decisions, the Third Circuit expressly looked to applicable state law to determine whether or not particular arbitration language was or was not unconscionable. Neither decision even hints that it might be the position of that Circuit that such determinations must be made without examination of the terms of the arbitration provision itself. And notably, the *Zimmer* opinion does not even cite *Gay*, despite the fact that it discusses the very same Pennsylvania lower court decisions which the *Gay* court discussed. A decision by this Court to address an alleged conflict among the Circuits should be based on firmer ground. The issue should be left to percolate further in the Third Circuit to allow that Court to resolve any internal conflicts in its approach to FAA preemption.

C. This Court's Decisions Make Clear That The Application Of Generally-Applicable State Law Contract Doctrines To Arbitration Provisions Is Not Preempted By The FAA

A final reason why this Court should not adopt T-Mobile's request that its petition in this case be granted and held pending resolution of *Laster*, is that this Court would almost certainly affirm the Ninth Circuit in *Laster* if it decided to accept the petition in that case. Thus, holding the petition in this case would be an empty and unnecessary act.

Section 2 of the FAA provides that agreements to arbitrate disputes shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." This Court's decisions make clear that generally applicable *state* contract enforcement rules provide the means for determining whether grounds "for the revocation of any contract" exist. "[S]tate law may be applied if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs. v. Casarotto*, 517 U.S. 681, 686-687 (1996) (quotation marks and citation omitted). However, to protect the FAA's intention that contracts to arbitrate be put "upon the same footing as other contracts" (*Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 [1974] [quoting H. R. Rep. No. 96, 68th Cong., 1st

Sess., 1, 2 (1924)]), a state may only apply generally applicable contract law when determining the enforceability of an arbitration agreement. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995).

Under these standards, there is no meaningful argument that the California Supreme Court's decision in *Discover Bank* is preempted by the FAA.[5] That decision did not preclude arbitration of the dispute raised in the case; to the contrary, the court expressly upheld the obligation of the parties to proceed to arbitration. While the court found unenforceable the portion of the contractual language which limited arbitration proceedings to individual resolution, it did so pursuant to a long-held generally applicable state contract doctrine – contractual provisions which directly or indirectly result in exculpation are not enforced in California. Cal. Civil Code §1668. Nor can there be any suggestion that the *Discover Bank* court singled out arbitration for special application of this doctrine, since the same conclusion (that contractual bars to group adjudication in small claim consumer cases are contrary to state public policy) was earlier

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[5] The ruling of the Ninth Circuit in *Laster* and the ruling of the California Court of Appeal in this case merely apply the *Discover Bank* decision to the cases before them in a non-controversial manner. As noted above, these two courts ordered the cases to proceed in court rather than arbitration only because T-Mobile's own contractual language required that result. Under *Discover Bank*, the cases would have been sent to arbitration for consideration of the possibility of class arbitration, but for T-Mobile's election otherwise.

applied in a case where no arbitration clause existed. *America Online, Inc., supra.*[6]

T-Mobile's petition in *Laster* suggests that it would ask this Court to find that the *Discover Bank* holding is preempted by the FAA because arbitration agreements should be "enforced according to their terms", thus purportedly protecting an arbitration clause's specification of "individual" resolution from application of generally applicable state contract doctrines. *Laster* Petition 12, 28 (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)). This argument cannot prevail, however.

The Court's opinion in *Volt Information Sciences* leaves no doubt that the FAA's preference for enforcement of arbitration agreements "according to their terms" is simply a subset of the FAA's *overall* purpose that arbitration agreements be enforced as are other contracts. Immediately before the language quoted by T-Mobile, the Court stated: "[The FAA] simply requires courts to enforce privately negotiated

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[6] In *America Online*, the California court addressed a forum selection clause designating a Virginia forum and application of Virginia law. The court reviewed the significance of class action procedures for vindication of consumer rights under California law and concluded: "The unavailability of class action relief in this context is sufficient in and by itself to preclude enforcement of the TOS forum selection clause." Because there was no arbitration provision in the contract at issue in the case, the court's decision cannot possibly be attacked as hostile to arbitration or based upon any unique attribute of arbitration.

agreements to arbitrate, like other contracts, in accordance with their terms. *See Prima Paint*, *supra*, at 404, n. 12 (the Act was designed 'to make arbitration agreements as enforceable as other contracts, but not more so')." 489 U.S. at 478. This "central purpose" of the FAA is implemented in Section 2 of the Act. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2003). But, of course, Section 2 is also precisely where the express limit on the enforceability of arbitral provisions is stated: " . . . save upon such grounds as exist at law or in equity for the revocation of any contract". 9 U.S.C. §2. Application of generally applicable state defenses to contract enforceability remains proper whether that application impacts the precise manner in which an arbitration proceeds or the enforceability of the agreement to arbitrate at all.

Put simply, the FAA's policy in favor of enforcing the specific terms of arbitration agreements has limits.[7] The main such limit is that those terms are subject to general state contract defenses, including

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[7] Recently, this Court found that contractual agreement to expanded judicial review of an arbitrator's rulings must give way to the FAA's own specified limits on such review. *Hall St. Assocs. v. Mattel, Inc.*, ___ U.S. ___, 170 L.Ed.2d 254 (2008). In response to the argument that the FAA generally favors enforcement of the terms of arbitration agreements, the Court stated: "But to rest this case on the general policy of treating arbitration agreements as enforceable as such would be to beg the question, which is whether the FAA has textual features at odds with enforcing a contract to expand judicial review following the arbitration." *Id.*, 170 L.Ed.2d at 264.

unconscionability. *Doctor's Assocs., supra*. Thus, for example, numerous courts have found the specification of an unreasonable forum in an agreement to arbitrate to be unconscionable if the cost of proceeding in that forum would act as a practical bar to any resolution of the dispute. *See, e.g., Bragg v. Linden Research, Inc.*, 487 F. Supp. 2d 593, 609 (E.D. Pa. 2007) (unreasonable forum for arbitration, together with unreasonable confidentiality provisions and required sharing of arbitration fees and costs, render agreement substantively unconscionable; applying California law); *Plattner v. Edge Solutions, Inc.*, 2004 U.S. Dist. LEXIS 13451 (N.D. Ill. April 1, 2004) (contractual requirement to arbitrate in New York unenforceable because "the forum selection clause effectively precludes plaintiff from bringing his claim"); *Hagedorn v. Veritas Software Corp.*, 250 F. Supp. 2d 857, 862 (S.D. Ohio 2002) (portion of arbitration agreement requiring Ohio resident to arbitrate in San Francisco is not enforceable); *Philyaw v. Platinum Enters.*, 54 Va. Cir. 364, 366 (Va. Cir. Ct. 2001) (clause requiring arbitration in a distant forum unconscionable under Virginia law where the cost of doing so "effectively eliminates any remedy for consumers"). *Cf. Mitsubishi Motors Corp., supra*, 473 U.S. at 637 n. 19 ("[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.").

Nor could T-Mobile successfully contend that the California courts should have come to a different conclusion regarding the exculpatory object of the wording of their contractual language. Whether the wording of a particular contractual provision does or does not show that it has the object "directly or indirectly, to exempt anyone from liability" for a violation of law (Cal. Civil Code §1688) is a question of *state* law. *Volt Information Sciences,* 489 U.S. at 473 ("the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review."). The FAA protects against State law applications grounded directly in arbitration *qua* arbitration and against outright discrimination against such clauses. But in the absence of either such practice, as here, the interplay between particular contractual provisions and state statutory policies remains an issue of state concern. The California Supreme Court determined that, in some factual circumstances, a contractual ban on group resolution of small claims falls within the state statutory prohibition on exculpatory contract provisions. Since that court decided that such cases should still be sent to arbitration, but with the possibility of group resolution intact, no substantial federal question is raised, under the FAA or otherwise. There is no federal policy favoring arbitration under a certain set of procedural rules. *Id.* at 476.

CONCLUSION

Respondent respectfully requests that the Court deny the Petition For A Writ Of Certiorari.

Dated: April 25, 2008

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IN THE

Supreme Court of the United States

T-MOBILE USA, INC.,

Petitioner,

v.

BRUCE GATTON, JEWELDEAN HULL, CHRISTINA NGUYEN, CONOR VAUGHAN, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED; AND CHRISTINA NGUYEN, ADRIANNE GRANT, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California, First Appellate District

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

In its Petition, T-Mobile USA, Inc., showed that the California Court of Appeal's refusal to enforce the terms of the parties' agreement to arbitrate individually conflicts with decisions of a number of federal circuit courts as well as this Court's application of Section 2 of the Federal Arbitration Act ("FAA"). Pet. 2-5. Petitioner further showed that this case presents a recurring issue of national importance that affects contracts benefiting countless consumers and businesses: whether state-law unconscionability principles may be employed to discriminate against and prevent the enforcement of agreements to arbitrate individually in cases involving claims by a consumer. *Id.* at 2-5, 10-11.

As T-Mobile previously noted, this case presents the same question as in *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008). The reply brief in *Laster* is being filed at the same time as this brief. Efficiency dictates that the petitions in both cases be considered together, and respondents have offered no legitimate reason why that course should not be followed. The petition for certiorari should be held pending the Court's disposition of *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008), and then disposed of accordingly.

A. The State Court's Decision Is Final And Reviewable, And Presents An Appropriate And Viable Vehicle For Review.

Respondents lead with the argument that the decision of the California Court of Appeal is not reviewable, lacks finality, and presents a poor vehicle for resolving this conflict. Opp. 2-6. These claims are baseless.

The decisions of lower state courts are final and reviewable when the state's highest court denies discretionary review. *Perry* v. *Thomas*, 482 U.S. 483, 489 & n.7 (1987) (reviewing FAA decision arising from California Court of Appeal where state supreme court denied review); *Preston* v. *Ferrer*, 128 S. Ct. 978 (2008) (same). Here, the decision of the California Court of Appeal was issued in reliance on *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), and the state supreme court subsequently denied review. Pet. App. 61a. The court's refusal to compel arbitration likewise is a "final judgment" for purposes of this Court's jurisdiction. *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-7 (1984). The decision below is both final and ripe for review.

Respondents' suggestion that the FAA does not apply in state courts is equally unfounded. Opp. 3. This Court has repeatedly reviewed state court decisions involving the FAA, and has expressly ruled that the FAA applies in state as well as federal courts. *Southland Corp.*, 465 U.S. at 15-16; see *also Preston*, 128 S. Ct. at 983; *Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440 (2006); *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468 (1989); *Perry*, 482 U.S. at 490-92.

Respondents' claim that petitioner is somehow "distrust[ful]" of arbitration is similarly misguided. Opp. 10. To the contrary, the severance provision in the arbitration agreement highlights the nature and importance of the underlying dispute. Here, the parties agreed to arbitrate individually any disputes that might arise, rather than doing so on a class-wide basis. Pet. App. 62a-64a. As this Court has explained, Congress enacted the FAA to ensure the enforcement of the procedures chosen by parties to resolve their disputes. *Volt Info. Scis., Inc.*, 489 U.S.

at 479. Thus, a fundamental benefit of arbitration is that "by agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 31 (1991) (quoting *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

Yet, the state court refused to enforce an essential term of the parties' agreement to arbitrate – their agreement to arbitrate on an individual basis – on grounds that violate the FAA. Pet. 9-10; Pet. for Certiorari at 25-29, *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008). As such, the inclusion of a severance provision underscores the importance attached to the parties' decision to resolve disputes individually, rather than through class-wide arbitration. T-Mobile does not challenge the state courts' enforcement of the severance provision, see Pet. App. 58a, but instead attacks the antecedent determination that individual arbitration is unconscionable and the resulting refusal to enforce the parties' agreement in accordance with its terms. This case squarely presents that issue, which, as shown below, is one of surpassing importance and implicates a substantial conflict among the federal courts of appeals.

B. The Decision Below Conflicts With Rulings By Numerous Other Courts.

Respondents also contend that the Third Circuit's decision in *Gay* v. *CreditInform*, 511 F.3d 369 (3d Cir. 2007), does not create a conflict among the circuits "worthy of this Court's review." Opp. 12. This is simply incorrect, as discussed in greater detail in the petition for certiorari filed in *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008), and in the

reply brief that is being filed in *Laster* concurrently with this brief.

C. The Decision Below, Like That In *Laster*, Violates The FAA.

Respondents next assert that the decision below, as well as that in *Laster*, "present no threat" to the FAA's policy "favoring enforcement of arbitration agreements." Opp. 6. That too is incorrect.

Respondents' contention that California is not "generally hostile to arbitration" and that the decision below favors arbitration, Opp. 6-7, is belied by the fact that the decision below, and the decisions on which it depends, refused to enforce the parties' agreement according to the parties' own terms. Pet. App. 24a.[1] As the California Supreme Court acknowledged in *Discover Bank*, class-wide arbitration requires a "greater degree of judicial involvement" than individual arbitration, and, in fact, is better characterized as a "*hybrid procedure* of classwide arbitration." *Discover Bank*, 113 P.3d at 1106 (internal quotation marks omitted) (emphasis added).

Under that "hybrid procedure," a "'court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement.'"

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[1] *See, e.g., Armendariz* v. *Foundation Health Psychcare Servs., Inc.*, 6 P.3d 669, 697 (Cal. 2000) (declaring that, instead of presenting an alternative to litigation, arbitration is "an inferior forum" that advantages one of the parties where the court perceived flaws in the agreement).

Id. (quoting *Keating* v. *Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982)). Nevertheless, such "judicial intrusion" into private arbitration is appropriate, the court concluded, given the "important role of class action remedies in California law." *Id.* *See also* *Muhammad* v. *County Bank of Rehoboth Beach*, 912 A.2d 88, 102 (N.J. 2006) (noting that "for a specific procedure to be considered 'class arbitration,' we presume that the essential elements of modern class actions would be present."), *cert. denied*, 127 S.Ct. 2032 (2007); *Bazzle* v. *Green Tree Fin. Corp.*, 569 S.E.2d 349, 362 (S.C. 2002) ("[P]rotection of the due process rights of absent class members is an essential component in all class actions, and one which may necessitate particular attention in class-wide arbitrations . . . ."), *vacated*, 539 U.S. 444 (2003).

Respondents candidly admit that class-wide arbitration is "undoubtedly longer and more involved" than arbitration on an individual basis. Opp. 11. But the parties did not agree to adopt "hybrid procedures" requiring substantial judicial intervention, and the refusal by the court below to compel arbitration clearly undermines the "FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms," including "the rules under which that arbitration will be conducted." *Volt Info. Scis.*, 489 U.S. at 479. Although a party who agrees to arbitrate "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985), judicial intrusiveness in "hybrid" class arbitration proceedings is so significant that even the California Supreme Court acknowledged that "'[a] good deal of care, and ingenuity, would be required to

avoid judicial intrusion upon the merits of the dispute, or upon the conduct of the proceedings themselves and to minimize complexity, costs, or delay.'" *Discover Bank*, 113 P.3d at 1106 (quoting *Keating*, 645 P.2d at 1209).

The substantial judicial intrusion mandated by the court below undermines the FAA's policy of promoting arbitration as a viable alternative to litigation. Indeed, the parties to this agreement preferred to abandon the arbitral forum altogether rather than risk the uncertain procedures and costs of judicially-mandated class arbitration. Far from affirming and supporting voluntary alternative dispute resolution agreements, the specific modifications necessary to create California's "hybrid" class procedures represent the very sort of discrimination that the FAA was intended to prohibit. See *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 270-73 (1995).

D. The State Law Applied Here Discriminates Against Arbitration And Is Preempted.

Finally, respondents argue, on the merits, that the refusal to compel individual arbitration in this case is specifically authorized by § 2 of the FAA. Opp. 15-20. As shown above, respondents' arguments are the very issues that have generated conflicts among the lower courts and that warrant resolution by this Court. In all events, those arguments should be rejected on the merits.

The suggestion that individual arbitration would "exculpate" petitioner from liability simply ignores contrary decisions that have held that individual arbitration allows consumers to effectively vindicate

their statutory rights. Here, respondents do not, and cannot, claim that they are individually unable to vindicate their rights. Indeed, "the relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983). Holding arbitration provisions unconscionable because they require individual arbitration is tantamount to "hold[ing] that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate." *Gay*, 511 F.3d at 395.

Finally, if there were uncertainty on this issue, "[t]he [FAA] establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone*, 460 U.S. at 24-25.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be held pending the Court's disposition of *T-Mobile USA, Inc.* v. *Laster*, No. 07-976 (filed Jan. 23, 2008), and then disposed of accordingly.

Respectfully submitted,

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